EXCESS OF AUTHORITY BY A COMPANY OR ITS MANAGERIAL PERSONNEL AND ABUSE OF AUTHORITY BY A MAJORITY OF SHAREHOLDERS

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PREFACE

The rapid growth of incorporated business and industry in this country has posed many problems in the domain of company law. Some more important among them belong to the regions of acts of companies or of their managerial personnel in excess of their respective authorities and the abuse of authority by majorities of shareholders. The purpose of this thesis is to examine these problems in the light of relevant legislation and judicial decisions and, where possible, to suggest measures for improvement of the relevant legal machinery.

This thesis has been divided into three parts. Part I deals with the topic of excess of authority by a company. When a company exceeds the authority permitted to it under the objects clause of its memorandum of association, it is said to have acted *ultra vires*. Such excess of authority has given rise to what is known in company law as the doctrine of *ultra vires*. It is this doctrine of *ultra vires* that Part I deals with. Chapter 1 of this Part is devoted to the exposition of the doctrine as such and Chapter 2 to the consequences flowing from its operation.

The topic of excess of authority by the managerial personnel constitutes the subject-matter of Part II. When

the managerial personnel of a company exceed the authority given to them by its articles of association, they do not, as a general rule, bind the company by those acts. There are, however, some exceptions to the general rule, provided the managerial personnel have not acted _ultra vires_ the company. These exceptions are: (1) Acts falling within the purview of the rule in _Royal British Bank_ v. _Turquand_, 5 El. & Bl. 248; 6 El. & Bl. 327; (2) acts duly ratified by the company; and (3) borrowing of money by the managerial personnel in excess of their authority, when the money has gone to the coffers of the company and has been utilised for its purposes. Chapters 1, 2 and 3 of this Part deal with the first, the second and the third exceptions respectively.

Part III of the thesis deals with the important topic of abuse of authority by majorities of shareholders. Such an abuse may hit (1) the minority alone, (2) the company as a whole, or (3) the "public interest". Abuse of authority which hits the minority alone and the reliefs against it, form the subject-matter of Chapter 1. Chapter 2 deals with the abuse of authority which hits the company as a whole and that which hits the "public interest", and reliefs against them.

In the preparation of this thesis, while I have made use of the relevant English and American law on the subject wherever it was deemed to be profitable, it has

been my endeavour to make it a work essentially on Indian law and to formulate and present an Indian view. The most important suggestion which emerges out of this work is in regard to the abolition of the doctrine of ultra vires so far as it affects the third party.

Some portions of this thesis have been published in the form of articles in eminent journals. Those articles are: (1) "Ultra Vires and Companies: The Indian Experience", International and Comparative Law Quarterly, London, Volume 12, at p. 967 (1963); (2) "Royal British Bank v. Turquand and Indian Law", Company Law Journal, Madras, Volume II, at p. 173 (1964); and (3) "Abuse of Authority by a Majority of Shareholders in a Company", Journal of the Indian Law Institute, New Delhi, Volume 6, at p. 380 (1964).

I wish to express my most sincere gratitude to my learned Supervisor, Professor Pradyumna K. Tripathi, Head of the Law Department and Dean of the Faculty of Law, University of Delhi, formerly Head of the Law Department and Dean of the Faculty of Law, University of Allahabad, whose able and ungrudging guidance made this work possible.

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C O N T E N T S

TABLE OF CASES

PART I

EXCESS OF AUTHORITY BY A COMPANY

When a company exceeds its authority, it is said to be acting _ultra vires_. This excess of authority by companies has given rise to what is known as the doctrine of _ultra vires_. It is with this doctrine of _ultra vires_ that this Part deals. The term _ultra vires_ has been used here in its strict sense as referring to those acts which are beyond the powers of a company itself to do, due to being outside the company's objects. This Part has nothing to do with (1) acts which are prohibited by company law or any other law, which acts should properly be termed illegal acts, and (2) acts which are within the powers of the company but are beyond the powers of the directors. Acts of the second category constitute the subject-matter of Part II of this thesis. The present Part consists of two Chapters. Chapter 1 deals with the doctrine of _ultra vires_ as such, whereas Chapter 2 deals with the consequences flowing from the operation of this doctrine.

CHAPTER 1

THE DOCTRINE OF ULTRA VIRES

The purpose of this chapter is to examine the origin and course of the doctrine of *ultra vires* in Indian Company law with reference to the relevant provisions of the Indian Companies Acts and the relevant case law.

THE COMPANIES ACTS

The first enactment regarding joint stock companies in India was the Registration of Joint Stock Companies Act, No. XLIII of 1850, which provided for the first time for the registration of joint stock companies.[1] The Supreme Courts of Judicature at Calcutta, Madras and Bombay were authorised to order registration of a company on a petition together with deed of partnership or a copy of the deed of partnership being presented to them.[2] The petition here was to contain many of those things which even now form part of the memorandum of association of a company having share capital, but

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1. See s. 1.
2. See ss. 2 and 3.

there was no clause corresponding to the objects clause.[3] Nor did the Act lay down what should be the contents of the deed of partnership or that the deed of partnership was to specify the objects of the company. This was in contrast to the position in England where section 7 of the Joint Stock Companies Act, 1844, required that the deed of settlement had to contain, inter alia, the business or purpose of the company, and section 25 required that, on complete registration, such company and its shareholders would be incorporated for the purpose of carrying on the trade or business for which the company was formed.[4]

The clause specifying and therefore delimiting the objects and thus the powers not being required, and the rule of ultra vires having its roots in the delimitation of such objects and therefore powers, it appears that the company registered under the 1850 Act was not accessible to the rule of ultra vires in the sense of acts which were beyond the power of the company to do.

The Act of 1850 was repealed and replaced by Act No. XIX of 1857[5] which was an "Act for the incorporation and regulation of Joint Stock Companies". This Act for the

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3. See s. 3. The limited liability clause there could not be as the principle of limited liability was introduced for the first time in the succeeding Act of 1857.

4. For these provisions of the English Act, see Dr. W. Horrwitz, "Company Law Reform and the Ultra Vires Doctrine" 62 L.Q.R. 66, 67 (1946).

5. S. 98 of this Act repealed the Act of 1850.

first time enabled the members of companies other than for the purpose of banking or insurance to limit their liability.[6] This Act replaced the petition and deed of partnership of the 1850 Act by memorandum of association[7] and articles of association[8] and required that the memorandum of association should state, inter alia, the objects for which the proposed company was to be established,[9] while the articles of association were for prescribing regulations for the company.[10]

This Act provided for alteration[11] of the articles of association by means of special resolution[12] but there was no provision in the Act for alteration of the memorandum of association except for change of name[13] of the company and increase of its capital.[14]

The Act of 1857 was repealed and replaced in 1866 by the Indian Companies Act (Act No. X of 1866).[15] The relevant provisions in the 1866 Act were contained in sections 6, 8, 11 and 12 which were quite similar to the provisions

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6. See s. 1.
7. See s. 1.
8. See s. 7.
9. See s. 3(3).
10. See s. 7.
11. See s. 38.
12. Which was defined in s. 39.
13. See ss. 4 and 103.
14. See Articles 21 and 22, Table B of the Schedule to the Act, and s. 7.
15. S. 219 of this Act repealed the Act of 1857.

contained in the corresponding sections of the (English) Companies Act, 1862.

Section 6 provided that any seven or more persons associated for any lawful purpose might form an incorporated company, with or without limited liability, by subscribing their names to a memorandum of association and otherwise complying with the requirements of the Act in respect of registration.

Section 8 provided that the memorandum of association should state, inter alia, the objects for which the proposed company was to be established.

Section 11 provided that upon registration, the memorandum of association would bind the company and its members to the same extent as if each member had subscribed his name to it, and there were in the memorandum contained, on the part of himself, his heirs, executors and administrators, a covenant to observe all the conditions of such memorandum subject to the provisions of this Act.

Section 12 provided that any company limited by shares might so far modify the conditions contained in its memorandum of association as to increase its capital or to consolidate and divide its capital into shares of larger amount than its existing shares, or to convert its paid-up shares into stock; but, except as aforesaid, and except as

hereinafter provided in the case of change of name, no alteration should be made by any company in the conditions contained in its memorandum of association.

It was from sections 6, 8, 11 and 12 of the (English) Companies Act, 1862 (that is, from provisions quite similar to those of sections 6, 8, 11 and 12 of the Indian Companies Act, 1866, given above) that the House of Lords, in the famous Ashbury case[16] deduced the doctrine of ultra vires[17]

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16. Ashbury Railway Carriage and Iron Co. v. Riche, L.R. 7 H.L. 653 (1875).

17. Lord Cairns, L.C., expounded the doctrine in the following words:

> "Now, my Lords, if that is so — if that is the condition upon which the corporation is established — if that is the purpose for which the corporation is established — it is a mode of incorporation which contains in it both that which is affirmative and that which is negative. It states affirmatively the ambit and extent of vitality and power which by law are given to the corporation, and it states, if it is necessary so to state, negatively, that nothing shall be done beyond that ambit, and that no attempt shall be made to use the corporate life for any other purpose than that which is so specified . . . The memorandum of association is, as it were, the area beyond which the action of the company cannot go . . . The question is not as to the legality of the contract; the question is as to the competency and power of the company to make the contract . . . . If every shareholder of the company had been in the room, and every shareholder of the company had said, 'That is a contract which we desire to make, which we authorise the directors to make, to which we sanction the placing of the seal of the company', the case would not have stood in any different position from that in which it stands now. The

for registered companies; though, perhaps, a different view was also possible on the basis of those provisions.[18]

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17. contd......

share-holders would thereby, by unanimous consent, have been attempting to do the very thing which, by the Act of Parliament, they were prohibited from doing". *Ibid.*, at pp. 670-672.

18. Prof. Edward H. Warren in "Torts by Corporations in Ultra Vires Undertakings", 2 C.L.J. 180, 187 (1926) expresses the opinion: "Such provisions, it is submitted, furnish an insufficient basis for concluding that the legislature intended that, even if all the members of the company acted in its name and with its funds to do an act outside the defined objects, no corporate significance should attach . . . . The question whether a particular corporation has general legal capacity or only special legal capacity must be answered by correctly interpreting the statute whereby or whereunder it was created. For reasons set forth above, it is submitted that the courts, when dealing with a statute of incorporation, ought to interpret that statute as conferring general legal capacity upon the corporation or corporations created thereby or thereunder, unless the intent of the legislature is clear to confer special legal capacity only. If that mode of approach is adopted, it is now further submitted that the Companies Act, 1862, contains no clear evidence of an intent by Parliament to confer special legal capacity only upon the corporations created thereunder".

Also, Profs. Ballantine, Lattin and Jennings in their book, *Cases and Materials on Corporations*, (2nd ed., 1953), speaking about the *Ashbury* case, say at p. 154: "The House of Lords made a sharp distinction between statutory companies and chartered companies in regard to the validity of contracts or transactions not covered by the objects clauses or their implications. There was no express enactment making unauthorised acts illegal and void, but any amendment or alteration of the objects clauses was prohibited. The court drew from this an implied prohibition of any contract outside of the scope of the purposes set forth . . . . If the English rule of general capacity of chartered companies had been followed in the *Ashbury* case as to

It may here by noted that, out of these four sections, the House of Lords put much reliance on section 8 which required objects to be stated in the memorandum of association, and section 12, which did not permit any alteration of those objects. This absolute prohibition to alter the objects is no longer there. It has been gradually relaxed by subsequent statutes, starting with the Indian Companies (Memorandum of Association) Act, 1895. Now, section 17 of the (Indian) Companies Act, 1956, allows alteration of objects for seven reasons by means of a special resolution confirmed by the Court. These provisions of section 17 and the liberality with which they are interpreted, leave good deal of scope for alteration of objects now. In England, the scope for alteration is even greater.[19] Thus, of the two strong pillars on which the House of Lords rested the doctrine of ultra vires, one is now badly damaged.

The company enactments in India, subsequent to the 1866 Act, did not make any worthwhile changes in the

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18. contd......
statutory companies the law of ultra vires both in England and in America would have had a much more reasonable and practical development".

19. S. 5 of the (English) Companies Act, 1948, allows alteration of objects for seven reasons by means of a special resolution, even without sanction of court. So the company itself has the full powers in regard to alteration, unless of course the requisite number of members or requisite number of debenture holders

relevant provisions except those given in the last paragraph. The subsequent enactments are not, therefore, being discussed here any more.

Further, the Indian Companies Act, 1866, laid down[20] that this Act, with the exception of Table A in the First Schedule, would apply to companies formed and registered under Act No. XIX of 1857 in the same manner as if such company had been formed and registered under this Act. This Act of 1866 came into operation on May 1, 1866, and so it meant that the four sections, namely, sections 6, 8, 11 and 12 of the Act of 1866, from the said day became applicable to a company formed and registered under Act XIX of 1857.

CASES ON ULTRA VIRES

It was in this setting of the company law that what appears to be the first case on ultra vires in Indian Company law arose in connection with a company formed and registered under Act No. XIX of 1857. It was Jahangir Rastamji Modi v. Shamji Ladha.[21] In this case the plaintiff was the registered shareholder of 601 shares in a company,[22] of which the

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entitled to raise objection to alteration of its objects, petition the court for cancellation of the alteration within 21 days after the date of the passing of the special resolution. If the court is not approached within this time, the alteration as effected by the company by means of the special resolution is final.

20. See s. 191.

21. 4 Bom. H.C.R. 185 (1866-67) decided by Sargent, J., on August 2, 1867.

22. The Financial Association of Europe and India (Limited) registered under Act No. XIX of 1857.

defendants were the directors. The plaintiff alleged that the objects of the association, as defined in the memorandum of association, did not include dealing in shares, nor the purchase of the company's own shares; yet the defendants as directors did deal in shares, and thereby incurred losses on behalf of the company, and did purchase 1,422 shares of the company. Two of the issues frame were: (1) whether the purchase of its own shares by the company was ultra vires, and (2) whether the purchase of shares in joint stock companies was ultra vires.

At the outset, Sargent, J., observed:

> "A long series of decisions of the courts of law and equity in England has decided that an incorporated joint stock company can do no act which is not expressly or impliedly authorised by . . . the deed of settlement of the company . . . It is therefore to the memorandum and articles of association that we must turn to determine whether those transactions are expressly or impliedly authorised; or as it has been sometimes expressed, whether they fall within the scope of the objects for which the company was established". (23).

After having thus described the rule of ultra vires, the learned Judge proceeded to examine the memorandum and the articles of association[24] of the company to find out if the

23. 4 Bom. H.C.R. 185, at p. 190.

24. It is clearly noticeable in this case that "his Lordship was inclined to place the same value on the articles of association as on the memorandum of association": S.R. Das, The Law of Ultra Vires in British India (Tagore Law Lectures, 1903) p. 36. This appears to be strange as the Acts of 1857 as well as of 1866 clearly required that the memorandum should state the objects for which the company was established and further that the articles of association should lay down the regulations for the company.

transactions in question were authorised by them and came to the conclusion that they were not authorised and were accordingly *ultra vires*.

It is rather surprising that the learned Judge in arriving at the rule of *ultra vires* did not make any reference to the relevant provisions of the Indian law, that is, sections 6, 8, 11 and 12 of Indian Companies Act, 1866. It would have been in the fitness of things, if the learned Judge, instead of borrowing the rule, should have based it on the provisions of the Indian Companies Act, 1866. From the passage quoted above, one gets the feeling that the learned Judge decided the case by the English law and not by the Indian law; though the relevant provisions of the two Acts[25] were quite similar.

While holding that the purchase by the company of its own shares was *ultra vires*, the learned Judge remarked:

> "I have not arrived at this decision without some regret, as I cannot but be aware of a fact perfectly notorious, that it has been the practice not only of companies similar to this, but for other companies, to purchase their own shares, and that this decision may press somewhat harshly upon individuals; but at the same time if the joint stock companies are to flourish, more specially in a country like this, it can only be by the public feeling assured that the courts of law while refusing to interfer with directors in carrying out the objects of these associations into

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25. That is, the (English) Companies Act, 1862, from certain provisions of which the House of Lords deduced the doctrine of *ultra vires*, as explained in the text; and the Indian Companies Act, 1866.

> full and complete activity, will prevent the application of the funds of the company to other than legitimate purposes and objects of the association". (26)

It appears from the above passage that the learned Judge brought to bear on his decision the peculiar Indian conditions also and it is clear from this passage that, in adhering to the rule of ultra vires, the learned Judge saw the utility that the public would be assured that the funds of the company would not be applied to things other than the legitimate purposes and objects of the company and that this was necessary for the joint stock companies to flourish. If we try to analyse this reasoning, the answer suggests itself that if the public was assured about this thing, more and more persons would like to invest their money by becoming shareholders and also they would not be hesitant in lending their money to companies.

REASONS FOR INTRODUCTION OF THE RULE

It comes to this that the rule of ultra vires was introduced into the Indian law by Sargent, J., because, in his opinion, it was necessary for the protection of the shareholders and the creditors of the company.

The next case of importance on the question was In re Port Canning Co. Ltd.[27] The objects clause of the

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26. 4 Bom. H.C.R. 185, at p. 198.

27. 7 Beng. L.R. (O.C.) 583 (1871), decided by Phear, J., of the Calcutta High Court on June 30, 1871.

memorandum of association of Port Canning Co. Ltd. was as follows:

> "The Company is formed with the object of securing valuable property in the new port and town of Canning and its immediate vicinity,
>
> "And of improving the property so acquired by building upon, letting, or selling it, as may be deemed most advisable,
>
> "And of undertaking the construction of public works calculated to facilitate trade, and also of constructing tramways, roads, docks, wharves and jetties upon the land so to be acquired,
>
> "And for all other purposes that may be essential or conducive to the attainment of or connected with the above objects". (28)

After some time of the establishment of the Company, the directors were induced to take a one-fourth share in, and become liable for, one-fourth of the cost of a mill for husking rice, to be established and set up by a separate company. A separate company, however, was not formed, and at length the directors (the company having then already contributed largely towards the purchase of the mill machinery and towards the building of the mill) resolved in order to avoid losing the money which they had advanced, to take over the entire mill, and to carry it on as the property of the Company. They accordingly made considerable purchases of rice for the purpose of being husked at the mill; some portion of it when husked was shipped to England by Messrs.

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28. <u>Ibid.</u>, at p. 586.

Pyari Chand Mitter & Co., as agents for the company under letters of guarantee from the directors, by which the directors promised to pay at maturity any redrafts which might be drawn on Messrs. Pyari Chand Mitter & Co. in respect of these shipments. In the due course of this business, Messrs. Pyari Chand Mitter & Co. in their own name drew seven bills of exchange against these shipments upon the several consignees thereof. The shipments reached their respective destinations, and were all sold at a loss. The consignees honoured the bills drawn upon them against the shipments, and drew redrafts upon the company to cover the amount of loss in each case. The Company went into liquidation during these transactions.

The present claims were preferred by the payees or endorsees under those redrafts. The liquidator, on behalf of the Company, resisted the claims on the ground that they arose out of transactions which were _ultra vires_ the Company and for which the Company could not be made responsible.

After examining all the four paragraphs of the "objects clause", Phear, J., came to the conclusion that trading in rice could not be permitted under any of those paragraphs[29] and so was _ultra vires_.

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29. The claiments contended that the fourth paragraph was large enough to permit rice trading. About this the learned Judge said: "I think this paragraph is simply supplemental to the preceding three paragraphs of the

As to the argument that an incorporated company had power to do everything which is not illegal or actually prohibited to it by the terms of its incorporation, the learned Judge remarked:

> "This is true as regards the means of carrying into effect the purposes for which the company is incorporated. But the principle thus contended for does not apply outside that limit. Perhaps, rather I should say, the company is by implication prohibited from engaging in undertakings which do not fall among the objects of its incorporation. I need not now advert to the great mischief, public and private, which might ensue, if joint stock companies were not held strictly to the terms of their incorporation. The interest of the public on the one hand and of the shareholders on the other, require that directors should be rendered powerless to use the strength and means of the company and to pledge its credits beyond the scope of these". (30)

Holding that trading in rice was _ultra vires_,[31] the learned Judge dismissed the claims of all the four claimants.

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29. contd......
 section and that the whole together amount shortly to this, namely, that the object of the company is to deal with certain land and to convert the whole or part of it into a convenient site for trade; and to do anything which may be incidental, or which may lend, to carrying this purpose into effect. Trade is in the order of things subsequent to the work which the Company by its Memorandum has set itself to do, not part of it". 7 Beng. L.R. 583, at pp. 597-598.

30. _Ibid._, at pp. 598-599.

31. In this case also, as in the previous one, namely, _Jahangir Rastamji Modi_ v. _Shamji Ladha_, there was no attempt made to examine the provisions of the Indian Companies Act, 1866, to see if the Indian Act warranted the rule of _ultra vires_. The learned Judge took the rule for granted and then proceeded to decide whether the impugned trading in rice was _ultra vires_.

It is clear from the passage last quoted that in the rule of *ultra vires*, Phear, J., saw the utility of it being in the interest of the public on the one hand and of the shareholders on the other. By "public", Phear, J., most probably meant creditors, because from among the members of the public, the creditors are the persons who are interested in seeing that the funds of the company which they look to for repayment of their loans are not wasted in unauthorised dealings. Thus, this was the same thing as the justification for the *ultra vires* rule given by Sargent, J., in *Jahangir Rastamji*'s case.

It may be noted that Phear, J., saw this utility of the *ultra vires* rule in connection with a short "objects clause", consisting of only four paragraphs, the fourth paragraph of which Phear, J., thought was "simply supplemental to the preceding three paragraphs". Whether this usefulness of the rule is still available, when the "objects clauses" are exceedingly long, consisting of a large number of paragraphs and when each of those paragraphs is considered an independent paragraph, is extremely doubtful.[32]

The question may be viewed also from the angle that in this case four innocent persons[33] had to suffer losses for, practically speaking, no fault of theirs but due to the

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32. See pp. 32-37, *infra*.

33. That is, the payees or endorsees under the redrafts, who were the claimants in this case.

technical rule of ultra vires. Theoretically, the doctrine of constructive notice of the contents of the memorandum may appear to be sound but when it comes to practice, its impropriety becomes evident because every lay member of the public cannot be expected[34] to go through and understand the correct scope of the memorandum of association of the company with which he proposes to deal. Thus, this case is evidence that the ultra vires rule was capable of operating as a trap for the general public as it proved to be for the four unlucky claiments in this case.

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34. See Re Jon Beauforte (London) Ltd., (1953) Ch. 131, and the comments of Prof. L.C.B. Gower and of the Law Quarterly Review on this case, as given below.

Prof. Gower in his book, The Principles of Modern Law (2nd ed., 1957) at p. 87 says: "The hardship that may be caused to completely innocent people is well illustrated by Re Jon Beauforte (London) Ltd. . . If it is argued that the contractors ought to have examined the company's memorandum, one can only say that, as the case illustrates, business is not in practice conducted in that way, and if coal merchants had to take these elaborate precautions before supplying fuel, either they or limited companies would speedily cease to exist".

In 69 L.Q.R. 166-167 (1953) the comment was made that: ". . . it based its conclusions on the ground that in practice the doctrine worked injustice to those who in good faith dealt with a company, for they could not be expected to consult its memorandum of association to determine whether or not the officers were engaging in activities not included within the purposes of the company . . . . This result is strong evidence that the rule of law which holds that whoever has dealings with a company must be held to have constructive knowledge of its memorandum is in conflict with ordinary commercial practice".

The third case which deserves mention here is Kathiawar Trading Co. Ltd. (in liquidation) v. Virchand Dinchand.[35] The appeal against the judgment of Parsons, J., was decided by a bench consisting of Sargent, C.J., and Bayley, J., and the judgment of the bench was delivered by Sargent, C.J. The suit which gave rise to this appeal was brought on April 2, 1890, by the liquidator of the Kathiawar Trading Company against the defendant who was one of the directors during the short existence of the company before going into liquidation, to recover the balance of moneys expended by the directors in the purchase of shares of various companies, on the ground that such share transactions were *ultra vires* the company. The company was duly registered as a limited company on June 23, 1864, under Act No. XIX of 1857. The company went into liquidation in 1867 and at the date of suit was still in liquidation. Of the five directors, two were at the date of suit dead and two were insolvents. So the defendant was the only director who was solvent and living.

Both the trial court[36] as well as the appellate court[37] held that dealing in shares was *ultra vires* the company and the directors were liable to restore to the

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35. 18 I.L.R. Bom. 119 (1894).

36. *Ibid.*, the trial court judgment appears at pp.122-125.

37. *Ibid.*, the appellate court judgment appears at pp. 128-132.

company the money spent on the ultra vires dealing. Again, both the courts held that the suit should be dismissed because of staleness of demand, the liquidators of the company having had full knowledge of the facts since the company went into liquidation, but no suit was filed until the expiration of twenty-three years. But on the question whether section 10[38] of the Indian Limitation Act (No. XV of 1877) applied to the case, the two courts differed. The trial court was of the opinion that section 10 applied to this case and Parsons, J., in coming to this conclusion, derived support from a passage where Lindley, L.J., had said: "A director of a company is certainly not a mere agent. It is his duty, among other things, to protect the company and to enforce its rights even against himself, and the conflict between his interest and his duty when he has misapplied the company's money prevents the statute of limitations from applying to an action brought against him by the company in order to recover such money".[39]

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38. Which was similar to s. 10 of the Indian Limitation Act (Act No. IX of 1908) or s. 10 of the (Indian) Limitation Act (Act XXXVI of 1963) in the respect relevant for the purposes of the present case. Section 10 of the Limitation Act, 1963, is as follows. "Notwithstanding anything contained in the foregoing provisions of this Act, no suit against a person in whom property has become vested in trust for any specific purpose, or against his legal representatives or assigns (not being assigns for valuable consideration) for the purpose of following in his or their hands such property, or the proceeds thereof, or for an account of such property or proceeds, shall be barred by any length of time".

39. Re Sharpe; Re Bennett; Masonic and General Life Assurance Co. v. Sharp, (1892) 1 Ch. 154, at p. 167

But the appellate court was of the view that section 10 of the Limitation Act did not apply to this case. The judgment proceeded to say:

> "It is, however, to be remarked that directors of a company are precluded, in England, from pleading the bar of the statute by virtue, either of a general rule of the court of equity applicable to all trustees or quasi-trustees or else by the Judicature Act of 1873, which is applicable to all persons 'holding' property upon trust, but that the question whether they are precluded in this country, depends exclusively upon whether they can, in the language of section 10 of the Statute of Limitations, be regarded as 'persons in whom the property of the Company is vested in trust for a specific purpose'." (40)

And after consideration of the question posed in the above passage the judgment concluded on this point in the following words:

> "On the whole, although directors of a company are quasi-trustees, we think it would be unduly straining the language of section 10 to say that they are persons in whom the property of the company is vested as contemplated by that section. It may perhaps be subject of regret that such should be the conclusion on the language of the section. If so, it will be for the legislature to amend the section". (41)

Thus, the suit to recover from the director the money which the directors had spent *ultra vires* was dismissed.

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40. 18[illegible] I.L.R. Bom. 119, at p. 130.

41. *Ibid*., at p. 131. This decision was subsequently followed in the *Bank of Multan Ltd., (in liquidation)* v. *Hukam Chand*, A.I.R. 1923 Lah. 58 (2), and *Liquidator of the City Hygienic Milk Supply Company Ltd*. v. *The Official Assignee of Madras*, 1 Comp.Cas. 39 (1931). In both of these cases, the directors etc., were sought to be made liable to pay moneys under section 235 of the Indian Companies Act, 1913 in respect of their acts of misfeasance, etc.

But this case focuses attention on one important point. In this connection, the passage from the judgment of Lindley, L.J., quoted with approval by the trial court and from which the trial court derived much support in holding section 10 of the Limitation Act applicable to directors, should not be forgotten. Further, the passage last cited from the judgment of the appellate court, where the appellate court threw a hint to the legislature to consider the question of amending section 10, is also significant. All these, unmistakably, underline the need for amending section 10 of the Limitation Act, 1963, to the effect that it is made applicable to directors of a company.

Another case worthy of notice is Ahmed Sait & Others v. The Bank of Mysore Ltd.[42] This was an appeal from the judgment of a single judge of the Madras High Court decreeing a suit by the Bank of Mysore based on a mortage deed for Rs.1,00,000. One of the pleas raised was that the memorandum of association of the plaintiff bank prohibited the bank from lending on mortgage, and that the suit transaction was therefore void, as being ultra vires, and not enforceable at the instance of the plaintiff. The judgment said: "In Brice on the Doctrine of Ultra Vires, it was laid down that 'property legally and by formal

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42. 59 M.L.J.R. 28 (1930) decided by a bench consisting of Ramesam and Cornish, JJ.

transfer or conveyance transferred to a corporation is in law duly vested in such corporation, even though the corporation was not empowered to acquire such property'. Under the Indian law mortgage was a transfer of interest in immovable property".[43]

After examining a few English and Indian decisions, the judgment concluded on this point thus: "Following the above decisions we think that the Bank of Mysore is entitled to sue".[44]

Thus the rule of ultra vires was not allowed to prevent the Bank of Mysore from recovering the money which it had advanced on mortgage though it seems[45] that the memorandum of association of the bank did not permit it to advance money on mortgage.

Another case meriting discussion here is Imperial Bank of India Ltd. v. Bengal National Bank Ltd.[46] Here, the Imperial Bank of India claimed against the Bengal National

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43. Ibid., at p. 29

44. Ibid., at p. 30

45. The memorandum of association of the plaintiff bank is not given in the report nor is there any mention in the judgment that the memorandum of association did not permit the bank to advance money on mortgage but it seems to be the case. Also the headnote of the case gives support to this conclusion as it says: "A bank which has lent money on a mortgage in spite of the prohibition by its memorandum of association to lend money on mortgage is entitled to sue on the mortgage to recover the money lent".

46. A.I.R. 1930 Cal. 536, decided by Costello, J.

Bank Ltd. which was in liquidation, a declaration that two debentures dated May 4, 1923, and August 1, 1923 respectively constituted charges upon all the undertakings, property and assets including the uncalled capital of the defendant bank. The plaintiff also claimed an account of what was due to them as the holders of those debentures and further that the debentures might be enforced by the sale of the property and the assets of the defendant bank. The claim was resisted by the defendants, *inter alia*, upon the ground that the issue and the acceptance of the debentures in question were *ultra vires* the memorandum of the defendant bank, and were illegal and unauthorised or at any rate *ultra vires* so far as the Imperial Bank of India was concerned by reason of certain provisions in the Imperial Bank of India Act (Act No.XLVII of 1920).

On the question of *ultra vires* thus raised, Costello, J., first examined the "objects clause" of the memorandum of association of the defendant bank to find out if raising money by debentures was *ultra vires* the defendant bank and came to the conclusion that it was not.[47] Then the learned Judge examined the provisions of the Imperial Bank of India Act to find out if advancing money on debentures was *ultra vires* the plaintiff bank and came to the conclusion that it was not, provided the debentures

47. *Ibid.*, at p. 537.

were taken, as in this case, as a collateral security. The Court thus decided in favour of the plaintiff bank and did not allow the rule of ultra vires to stand in the way of the plaintiff bank recovering the money which it had advanced to the defendant bank.[48]

In this case and in the preceding case, though the rule of ultra vires was not allowed to work any injustice, it is clear that it was invoked in order to frustrate[49] obligations which ought to have been fulfilled in good conscience.

Another case deserving consideration here is In Re Madras Native Permanent Fund Ltd.[50] This was a misfeasance summons under section 235 of the Indian Companies Act, 1913. Certain breaches of duty were alleged against the directors and some other officers of the company and the summons asked that they might be ordered to bring

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48. Ibid., at pp. 538-539.

49. See Anglo-Overseas Agencies Ltd. v. Green, (1961) 1.Q.B.1.; and the editorial comments on this case in 77 L.Q.R. 12 (1961) which are: "The only effect of the present rule is to enable from time to time either the company or the persons with whom it has purported to enter into a contract, to avoid, by means of a technicality, an obligation that ought to be binding in good faith".

50. 60 M.L.J.R. 270 (1931).

into Court a sum of about Rs.42,000. An objection *in limine* was taken that the applicants had no *locus standi*. If they were creditors as they alleged themselves to be, they could apply under section 235. The question was, were they creditors of the company?

The company was started in 1878 under the name of the Madras Native Permanent Fund Ltd., with a capital of rupees two lakhs. The objects of the company as stated in the memorandum of association were to make advances to shareholders upon security of movable or immovable property for enabling them to purchase, build and repair houses and to grant to them simple loans to a limited extent and to do such things as were incidental to the attainment of the above objects. In 1887, a new branch was started and was called the Deposit Branch, to distinguish it from the Loan Branch, the name adopted to designate the Company's original activities. The capital of the Company was raised and the newly raised shares were allotted to the Deposit Branch.

While the Loan Branch was confined to the original objects, the Deposit Branch developed into an ordinary bank and carried on banking business. In the Deposit Branch there were deposits and advances, customers depositing money and loans being advanced on pledges of jewels. The customers of the bank included both members and strangers. This went

on far about forty years and it was then found that the Company's affairs were not being conducted satisfactorily. The Company having sustained a loss, the depositors were unable to get back their moneys. A liquidation petition was filed and a compulsory order was made in May, 1927. Some of the depositors in the bank were the applicants in this misfeasance summons.

Dismissing the application, Venkatasubba Rao, J., made the following observations:

> "The short question I have to decide is, are the amounts due to them debts? In other words, are the lenders in the eye of the law, creditors and is the borrowing company, debtor? This point is now well settled by authority. Where the carrying on of a business by the company was ultra vires, it was held that the ultra vires transaction created no debt, either legal or equitable. This was held in Re Birkbeck Permanent Benefit Building Society. (51) The facts of that case resemble those of the present. A building society carried on a banking business altogether beyond what was authorised. Cozens-Hardy M.R. observes that the so-called contracts of loan, though not illegal, are void and in truth have no existence. This is treated as the doctrine as to ultra vires borrowing. The case went up to the House of Lords and this view was affirmed, although on another point the decision of the Court of Appeal was varied (Sinclair v. Brougham) (52) The relation between the depositors and the company is not that of debtor and creditor and the only possible remedy for the person who has paid the money is one in rem and not in personam. This is a most unequivocal declaration, that ultra vires transactions do not create the relationship of debtor and creditor. The preliminary objection, therefore, must be upheld and on this short ground the application is dismissed". (53)

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51. (1912) 2 Ch. 183.

52. (1914) A.C. 399.

53. 60 M.L.J.R. 270, at pp. 273-274.

The learned Judge went on to say: "From this it does not follow that the lenders can, in no circumstances, recover their deposits. The very case I have cited, Sinclair v. Brougham, decides what their rights are and how and to what extent they can be enforced."[54] The depositors to whom moneys were due from the Deposit Branch, had already under orders of the Court been paid sums amounting to over a lakh. The learned Judge further indicated certain sums of money which he directed the liquidators to distribute among the depositors of the Deposit Branch.

In this manner, the depositors were repaid only about 75 per cent of their deposits. They suffered losses of about 25 per cent. of their deposits for, practically speaking, no fault of theirs[55] but due to the technical rule of ultra vires. Thus, the rule of ultra vires operated here also, as in Re Port Canning case, as a trap for outsiders who dealt with the company with a clean conscience. Fair-play demanded that the depositors, in the present case, should have been treated as creditors and the Company should have been made liable to them for the full deposits. The

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54. Ibid., at p. 274

55. Because when a person finds that a certain company is doing the business of banking for a number of years and so many persons are dealing with the company in that capacity, as in this case, he shall never, speaking from a practical standpoint, bother to inquire whether the company is authorised to do banking business or not.

Company, in their turn, should have recovered the amount that it had to pay for ultra vires transactions, from the directors responsible for taking the Company on the ultra vires path. If this was accepted, it was necessary that there should be no fixed period of limitation for recovering money from the directors but it should be unlimited, that is, section 10 of the (Indian) Limitation Act, 1963, should be made applicable to directors of a company.[56] This was necessary so that directors might not escape their liability by resigning their posts and the lapse of some time after that.

The last case to be discussed here is Wamanlal Chhotalal Parekh v. Scindia Steam Navigation Co. Ltd.,[57] decided by Stone, C.J., and Kania, J. This was an appeal from the judgment of Chagla, J., whereby he dismissed the appellant's suit for a declaration and certain ancillary relief. The appellant was a shareholder in the respondent company, and sued, on behalf of himself and other shareholders of the company, not only the company but also its nine directors personally. The appellant's

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56. See discussion of the case Kathiawar Trading Co. Ltd. v. Virchand Dipchand, supra.

57. A.I.R. 1944 Bom. 131.

complaint arose out of a transaction whereby the respondent Company invested twenty-five lakhs of rupees in the purchase of bullion and deposited it at a bank. The appellant alleged that such a transaction was ultra vires the respondent company.

The company was incorporated on March 27, 1919, under the Indian Companies Act, 1913. The following information about the company's objects appears in the judgment of Stone, C.J.:

> "Clause 3 of the memorandum of association is the objects clause. Sub-Clause (a) is: 'To purchase or otherwise acquire the steamship Loyalty . . . .' Sub-Clause (b) is: 'To purchase, charter, hire, build or otherwise acquire, steam and other ships or vessels, with all equipments . . .' etc. Sub-Clause (c) is as follows:
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> '(c) To buy, sell, prepare for market, and deal in coal, timber, live stock, meat, and other merchandise and produce'. Sub-Clause (d) is concerned with the carrying on of certain business and sub-clause (e) with insurance while sub-clause (f) makes provision for the carrying on of certain ancillary businesses, and then come sub-clauses (g) and (h) on both of which the respondents rely. They are as follows:
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> '(g) To acquire and deal with the property following: (1) The business property and liabilities of any company, firm, or person carrying on any business within the objects of this company. (2) Lands, buildings, easements and other interests in real estate. (3) Plant, machinery, personal estate and effects. (4) Patents, patent rights, inventions, or designs. (5) Shares or stock or securities in or any company or undertaking the acquisition of which may promote or advance the interestsof this company'.
>
> '(h) To perform or do all or any of the following operations, acts, or things: (1) To pay all the costs, charges and expenses of the

> promotion and establishment of the company. (2) To sell, let, dispose of, or grant rights over all or any property of the company. (3) To erect buildings, plant and machinery for the purposes of the company. (4) To manufacture plant, machinery, tools, goods and things for any of the purposes of the business of the company. (5) To draw, accept and negotiate bills of exchange, promissory notes, and other negotiable instruments. (6) To borrow money or to receive money on deposit either without security or secured by debentures, debenture stock (perpetual or terminable), mortgage or other security charged on the undertaking or all or any of the assets of the company including uncalled capital. (7) To lend money, with or without security, and to invest money of the company in such manner (other than in the shares of this company) as the directors think fit.' The remaining clauses are not material". (58)

These being the objects, the question was whether what was done was ultra vires the company or not. Both of the learned Judges delivered separate judgments. Stone, C.J., came to the conclusion that purchasing bullion was not permitted by clause (3)(h) (7) of the memorandum, while Kania, J., came to the conclusion that purchasing bullion was permitted by that clause.

But both of them were unanimous in arriving at the conclusion that purchasing bullion was permitted by clause (3)(g) (3) of the memorandum. In this connection, Stone, C.J., observed:

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58. Ibid., at p. 131, col. 2.

"The relevant sub-clause is sub-clause (3)(g), which is as follows: 'To acquire and deal with the property following', and sub-head (3) is: 'Plant, machinery, personal estate and effects'. Neither this sub-head nor its immediate predecessor, which deals with land, is qualified by such words as 'within the objects of the company' or 'for the purposes of the company' which are attached to some of the other sub-heads; and, in my opinion, sub-clause 3(g) is very wide indeed . . . . Turning again to sub-clause (3)(g), unquestionably the company had acquired the bullion. It dealt with it in the first instance, by depositing it for safe custody at its bank, and recently the war situation having changed, the company has sold it. Bullion is, in my opinion, personal estate within the meaning of sub-head (3) of sub-clause 3(g). I cannot see that the expression 'personal estate and effects' is to be restrained or narrowed by the context from having the widest meaning; nor, in my judgment, can these words be read ejusdem generis with plant and machinery. The words appear to be comprehensive words imported for the very purpose of making the previous catalogue unrestricted". (59)

It was argued on behalf of the plaintiff-appellant that if powers which were not objects of the company were included in the memorandum, they did not become objects. In support of this contention, certain observations of Lord Wrenbury in Cotman[60] v. Brougham[61] were relied upon. To this, Kania, J., replied:

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59. Ibid., at p. 134, col. 1.

60. (1918) A.C. 514.

61. These observations were as follows:

"There has grown up a pernicious practice of registering memoranda of association which, in the clause relating to objects, contain paragraph after paragraph not specifying or delimiting the proposed

> "These observations may be useful to remember when a company has to be registered, but, as observed by all the Law Lords in the same case for the purpose of construing whether a transaction was *ultra vires* or not, as the company was registered, the court was bound to admit that it was a valid instrument. That is the effect of section 24 (62) of the Companies Act, also. The criticism therefore against the wide scope of the objects clause in the memorandum of association is not helpful to the plaintiff". (63)

Thus it was held that the company's action was not *ultra vires* and on this ground the appeal of the plaintiff-appellant was dismissed.

Two things are clear from what has been given above about this case. First, the objects clause of the Company in question was very lengthy consisting of a number of paragraphs[64] couched in language capable of very wide import, and, secondly, the court did not at all restrict the meaning

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61. contd......
trade or purpose, but confusing power with purpose and indicating every class of act which the corporation is to have power to do. The practice is not one of recent growth. It was in active operation when I was a junior at the Bar. After a vain struggle I had to yield to it, contrary to my own convictions". *Ibid*., at p. 523.

62. Now s.35 of the (Indian) Companies Act, 1956.

63. A.I.R. 1944 Bom. 131, at p. 135, col. 2.

64. The exact number of paragraphs is not known. The portion of the report which speaks about the objects of the company is a part of the judgment of Stone, C.J., and has been quoted in full in the text. After giving either in full or in brief sub-clauses from (a) to (h) of the objects clause, it says at the end "The remaining clauses are not material".

of that language but, instead, allowed it to have its full and unrestricted effect. The objects clause of the Company in question is not an exception but the common trend these days is to have objects clauses exceedingly lengthy, possibly much lengthier than this, worded very extravagantly, so as to be capable of admitting almost every activity within their fold. To take only three illustrations:

(1) The "object clause" of the memorandum of association of Bharat Ball Bearing Co. Ltd.,[65] consists of as many as forty-five paragraphs, most of them lengthy and including "objects", *inter alia*, "To carry on trading business in all its branches",[66] "To receive fixed or other deposits",[67] "To carry on the business of import and export in all its branches";[68] and "To do all or any of the above things in any part of the world and as principals, agents, contractors, trustees, or otherwise, and by or through trustees, agents or otherwise and either alone or in conjunction or partnership with others".[69] Paragraph 45 says ". . . and the intention is that the objects specified in each paragraph of this clause shall, except where otherwise expressed in such paragraph, be independent main objects and shall be in

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65. Incorporated on December 28, 1960, under the (Indian) Companies Act, 1956, by the Registrar of Companies, Delhi.

66. See Memorandum of Association of Bharat Ball Bearing Co., para 13.

67. *Ibid.*, para 32.

68. *Ibid.*, para 18.

69. *Ibid.*, para 44.

no way limited or restricted by a reference to or inference from the terms of any other paragraph or the name of the company". And not being content with all this, paragraph 43 gives the company the power to pursue, besides so many "objects" which are expressed, "all such other things as the company may think conducive or incidental to the attainment of any of the above objects".

(2) The "objects clause" of the memorandum of association of Modella Woollens, Ltd.,[70] consists of fifty paragraphs, with a provision at the end: "It is expressly declared that the several sub-clauses of this clause and all the powers thereof are to be cumulative and in no case is the generality of any one sub-clause to be narrowed or restricted by any particularity of any other sub-clause, nor is any general expression in any sub-clause to be narrowed or restricted by any particularity of expression in the same sub-clause or by the application of any rule of construction *ejusdem generis* or otherwise".[71]

(3) The objects clause of the memorandum of association of Chemicoat, Ltd.,[72] consists of as many as sixty-three paragraphs, including paragraphs expressed in language so

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70. Incorporated on July 28, 1961, under the Companies Act, 1956, by the Registrar of Companies, Maharastra.

71. Para 50 of the Memorandum of Association of Modella Woollens, Ltd.

72. Incorporated on March 21, 1961, under the Companies Act, 1956, by the Registrar of Companies, Gujarat.

general and wide as: "To carry on trade, agriculture, business, manufacture venture or commercial operations in India or in any other part of the world in connection with any merchandise, commodities, goods, wares, produce, products, articles and things and to purchase or otherwise acquire and to sell or otherwise dispose of or deal in, either for future or ready delivery and either absolutely or conditionally, or to manufacture or do work upon any merchandise, commodities, goods, wares, produce, products, articles and things dealt or traded in by the company and to cover any such purchases or sales by options, cross-contracts or otherwise".[73]

Now these lengthy objects clauses, expressed in language capable of almost unlimited import, are, according to the rule of interpretation of the objects clause adopted in Maganlal Chhotalal Parekh's case, to be given their full and unrestricted meaning. That means the vanishing point of delimitation of objects by the objects clause which, in its turn, means the vanishing point of the protection to shareholders and creditors, because that rested upon delimitation of objects by the objects clause.

Due to these developments, the doctrine of ultra vires introduced into Indian law by Sargent, J., with the aim

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73. See para 41 of the Memorandum of Association of Chemicoat, Ltd.

that it was necessary for protection of the shareholders and creditors of the company, which aim it fulfilled so long as objects clauses continued to be short and simple, has ceased to afford any real protection[74] to the shareholders or creditors of the company.

Thus the doctrine of ultra vires has had to surrender its virtue to later developments. But it still retains its vice, namely, that it can be a pitfall, as before,[75] for the outsider who deals with the company because there can even now be some such activity which a company cannot pursue under its "objects clause". If the company pursues that very activity, the persons who deal with the company in connection with that activity cannot recover anything from the company which may be due to them in regard to that dealing, for example, for goods supplied or services rendered to the company.

A doctrine which is now devoid of any virtue but which has still the potentiality for vice, namely, which can

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74. An editorial comment on Salmon, J.'s, decision in Anglo-Overseas Agencies Ltd. v. Green, (1961) 1 Q.B.1. made in 77 L.Q.R. 12 (1961) stated something similar: "This raises the question whether there is any useful purpose served by the ultra vires rule when such unlimited powers can be given to a company by drawing the memorandum of association in these terms. A shareholder, who thinks that he is protected by a clause stating the objects of the company in precise terms, may find that he has been completely misled because of a later omnibus clause".

75. As it proved to be in the Port Canning Co. case, supra and in Madras Native Permanent Fund Case, Supra.

allow persons[76] to avoid with impunity an obligation which ought to be fulfilled in good conscience and can thus be a trap for the other innocent party has no justification for its existence.

POSITION UNDER ENGLISH LAW

The position under English law is similar. There, the Committee on Company Law Amendment, popularly known as the Cohen Committee, in its Report submitted in June 1945, had expressed the opinion:

> "In consequence the doctrine of ultra vires is an illusory protection for the shareholders and yet may be a pitfall for third parties dealing with the company. For example, if a company which has not taken powers to carry on a taxi-cab service, nevertheless does so, third persons who have sold the taxi-cabs to the company or who have been employed to drive them, may have no legal right to recover payment from the company. We consider that, as now applied to companies, the ultra vires doctrine serves no positive purpose but is, on the other hand, a cause of unnecessary prolixity and vexation". (77)

For these reasons, the Cohen Committee had recommended:

> "We think that every company, whether incorporated before or after the passing of a new Companies Act, should, notwithstanding anything omitted from its memorandum of association, have as regards third parties the same powers as an individual. Existing provisions in memoranda as regards the powers

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76. Both natural as well as artifical, in theory at least, but in practice the artificial, i.e., the company alone. In this connection see text to note 88 of the next chapter.

77. See Report of the Committee on Company Law Amendment, 1945 (Reprinted 1958), Cmd. 6659, para 12.

of companies and any like provisions introduced into memoranda in future should operate solely as a contract between a company and its shareholders as to the powers exercisable by the directors". (78)

This recommendation for abolition of the doctrine of *ultra vires* was not enacted into the Companies Act, 1948,[79] and this failure has been regretted by many eminent writers in the field.[80]

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78. *Ibid*.

79. The reasons for failure to abolish the *ultra vires* doctrine were stated in a memorandum of evidence submitted by the Board of Trade before the Jenkins Committee in the following words: "When the bill amending the 1929 Act was being prepared, the Board were advised that it would not be a simple operation to give effect to this suggestion of the Cohen Committee. A third party might find himself unable to enforce a contract against a company either on the ground that it was outside the scope of the company's objects or on the ground that it was beyond the authority of the directors. In both cases he would be affected with notice of the limits imposed by the objects clause of the company's memorandum, which was a public document. Merely to abrogate the *ultra vires* rule in relation to the company would in practice leave the third party no better off, since the objects clause would still affect him with notice of the limits on the authority of the directors. Nor would it be likely to reduce the prolixity of modern memoranda, since directors would have a strong incentive to protect themselves by procuring the company to extend the authority given them by the objects clause. To give effect to the suggestion of the Cohen Committee it would therefore be necessary to modify, if not to abrogate, the rule that the memorandum is a public document, of which third parties dealing with the company are deemed to have notice. In view of the prevailing pressure of work and the need for rapidly implementing the main recommendations of the Cohen Committee, the Board decided that they would not be justified in holding up the preparation of the Bill in order to work out what appeared to them to be a far-reaching change which might involve highly complicated drafting." — See *Report of the Company Law Committee*, 1962, Cmnd. 1749, para 38.

80. For example, see Gower, *op. cit.*, at p. 87; Palmer, *Company Law*., p. 86 (20th ed. 1959); Charlesworth,

The next committee on company law amendment in England, popularly known as the Jenkins Committee, saw many difficulties[81] in the implementation of Cohen Committee's

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80. Contd.........
Company Law, p. 21 (7th ed. 1960); Pennington, The Principles of Company Law, p. 67 (1st ed. 1959); and the editorial comments of the Law Quarterly Review referred to *supra* in notes 34, 49 and 74.

81. The difficulties and problems involved, according to the Jenkins Committee, were:

(i) Those who favoured the abolition of the *ultra vires* principle sought to achieve their object by legislation to the effect that notwithstanding anything contained in or omitted from its memorandum of association every company was to have as regards third parties all the powers of a natural person.

(ii) But a company not being in fact a natural person could only act through directors or other agents exercising powers delegated to them by the company.

(iii) What, then, is the extent of the delegation to be? The company could (apart from legislation to the contrary) presumably adhere to the plan now usual of making by its articles an "omnibus" delegation of its powers to its directors.

(iv) The position then would be that the company would have all the powers of a natural person, and that these powers (with the usual statutory exceptions, which are not material for the present purpose) would be exercisable in their entirety by the directors.

(v) Would not this state of affairs place too much power in the hands of the directors? Present complaints regarding the state of company law are often to the effect that shareholders should be given greater and more effective control over the activities of directors. From this point of view the omnibus delegation to the directors of all the powers of a natural person conferred on the company by the proposed legislation seemed to the Committee a retrograde step.

(vi) Moreover, would not investors and creditors and the public at large justifiably wish to know what activities the company was pursuing or presently intending to pursue within the ambit of its all-embracing powers of

recommendations and expressed the opinion: "In these circumstances it seems to us that the best course will be

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81. contd.......
a natural person, and to have some particulars as to existing or proposed activities in some public document available for inspection?

(vii) Once it was accepted that some limit is to be set upon the extent of the powers delegated to the directors, how is to be done? The Cohen Committee's plan was in effect to make the objects clause operate only as between the shareholders and the company, by way of definition of, or limitation upon, the powers of the company exercisable by the directors. If this were done, would not the third party be fixed with notice of the objects in their new guise, and of the limitations which they imposed, in accordance with the general rule that anyone dealing with a company was deemed to have notice of its public documents? Would not _ultra vires_ difficulties creep in again, as it were on a lower level? Would not the third party be concerned to see that the directors were not exceeding their delegated powers? And would not the directors on their part be concerned to see that the objects clause stated the scope of their delegated powers with the greatest possible width and particularity (incidentally leaving objects clauses as prolix as they are today)?

(viii) Thus the third party if fixed with constructive notice of the extent of the director's delegated powers would be little better off under the new law than he was under the old. If on the other hand, the new law absolved him from notice, would the objects clause in its new guise afford any protection to the shareholders? The Jenkins Committee doubted if it would.

(ix) To give complete protection to the third party it would be necessary to absolve him not only from constructive, but also from express, notice of any limitation upon the directors' delegated powers. In other words he would have to be deemed not to know things which he actually did know — a legislative expedient which seemed to the Jenkins Committee to be highly undesirable. — See _Report of the Company Law Committee_, 1962, referred to _supra_ in note 77, para 39.

to attempt no general repeal of the existing law of ultra vires in relation to companies registered under the Companies Acts but to provide protection to third parties contracting with companies (i) against the unfair operation of the ultra vires rule and (ii) by abrogating the rule, already mitigated by the decision in Royal British Bank v. Turquand, . . . that third parties are fixed with constructive notice of the contents of a company's memorandum and articles of association".[82]

Further, the Jenkins Committee specifically recommended that:

> "(a) a contract entered into between a company and another party . . . contracting with the company in good faith should not be held invalid as against the other party on the ground that it was beyond the powers of the company: he should not, however, be allowed to enforce the contract without submitting to perform his part of it so far as it is unperformed; (b) in entering into any such contract the other party should be entitled to assume without investigation that the company is in fact possessed of the necessary power; and should not by reason of his omission so to investigate be deemed not to have acted in good faith, or be deprived of his right to enforce the contract on the ground that at the time of entering into it he had constructive notice of any limitations on the powers of the company, or on the powers of any director or other person to act on the company's behalf, imposed by its memorandum or articles of association; (c) the other party should not be deprived of his right to enforce the contract on the ground that he had actual knowledge of the contents of the memorandum and articles at

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82. See Report of the Company Law Committee, 1962, para 41.

> the time of entering into the contract if he honestly and reasonably failed to appreciate that they had the effect of precluding the company (or any director or other person on its behalf) from entering into the contract in question; (d) there should be no change in the position of a company in relation to ultra vires contracts entered into by it". (83)

These recommendations of the Jenkins Committee have been criticised.[84] Assailing the proposal of the Jenkins Committee to retain the doctrine of ultra vires and still to make an ultra vires contract binding in relation to third parties, the learned critic expresses the opinion that this proposal "would thus create a situation where the already complex concept of corporate personality would be still more confused, and the resulting inconsistency, while of no consequence to those concerned solely with the practical application of company law, must prove unacceptable to students of jurisprudence. This, to use the Committee's own words, would indeed be an undesirable legislative expedient".[85] He pleads for a careful combination of the recommendations of the two Committees.[86]

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83. Ibid., para 42.

84. See J.H. Thompson, "The Ultra Vires Doctrine and the Jenkins Report", (1963) J. Bus. L. 143.

85. Ibid., at p. 148.

86. In conclusion, Thompson says: "The Cohen Committee recognised the need for radical reform of the legal rules restricting a company's powers without appreciating fully the intrinsic difficulties of so doing.

<u>POSITION IN THE UNITED STATES OF AMERICA</u>

Originally, the position in the United States was similar to the Indian position or the English position. The idea that *ultra vires* contracts were void and of no legal

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86. contd.......

The Jenkins Committee also recognises the need for reform, has found the difficulties of major alteration unsurmountable, and has unwittingly demonstrated how they can be surmounted. A combination of the recommendations of the two committees with certain modifications, would have the effect not only of protecting the interests of third parties dealing with a company, but also of producing a much-needed simplification of the law. This might be achieved by the outright abolition of the *ultra vires* doctrine, thereby restoring the former common law position under which companies had the same powers as natural persons, but, following Cohen, retaining the objects clause in the memorandum, which should serve, like the articles, as a contract between the company and its members in defining the powers of the directors. The effect of the operation of the doctrine of constructive notice could then be avoided by a modified version of the Jenkins proposal, whereby a third party would be entitled to assume that <u>the board of directors</u> had all the necessary powers to contract with him. This might be extended to include also a managing director, leaving the powers of individual directors and other agents to be governed by the 'ordinary course of employment' rule, powers of delegation being implied within these limits. The recommendation that actual knowledge should not in itself operate against a third party might also be included, although not essential, and although in conflict with the general principles of agency, in view of the difficulties inherent in dealing with a company. The effect of such a change would be to rationalise and simply the law, to give adequate protection to third parties, and to safeguard the position of the general body of shareholders, while at the same time enabling interested parties to ascertain the spheres in which the directors have power to act (in deference to the Jenkins Committee's view that this is desirable). Individual shareholders and creditors, however, would be in a less favourable position. An *ultra vires* act

effect, gained a firm foothold in American Jurisprudence due to the decision of the Supreme Court of the United States in Central Transportation Co. v. Pullman's Palace Car Co.,[87] wherein Justice Gray said: "A contract of a corporation, which is ultra vires, in the proper sense, that is to say, outside the object of its creation as defined in the law of its organisation, and therefore beyond the powers conferred upon it by the legislature, is not voidable only, but wholly void, and of no legal effect. The objection to the contract is, not merely that the corporation ought not to have made it, but that it could not make it".[88]

This view as to the nature of the ultra vires contract became the settled rule in the federal courts and also in some state courts. A number of grounds were offered in support of this rule. Oleck, attributing this enumeration to Fletcher, lists the following five grounds as having been offered in support of this rule: (1) Want of corporate

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86. contd.......
of the directors could be approved by a majority of shareholders, and neither minority shareholders nor creditors would be able to prevent this under the existing law, although a suitable amendment to the law for the benefit of such persons would not be difficult to formulate. But this question cannot satisfactorilly be dealt with in isolation: it must be considered in the general context of the existing rules and recent recommendations on the protection of minorities, a topic outside the scope of this article" see (1963) J. Bus. L. 143, at pp. 148-149.

87. 139 U.S. 24 (1890).

88. Ibid., at p. 59.

power to make the contract, (2) illegality, (3) notice of the limitations on corporate powers, (4) public policy, and (5) protection of the rights of stockholders.[89] According to Oleck, none of these grounds has proved to be completely satisfactory.[90]

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89. See Oleck, Modern Corporation Law, vol. 2, at p. 639 (1st ed. 1959).

90. Oleck, op.cit., at pp. 639-644, discussed all the five grounds as he considers such a discussion desirable as a means of providing a more complete understanding of the common law background of the doctrine.

About the first of these grounds, Oleck says: "The first of these grounds, want of corporate power, is a logical deduction from the fiction and concession theories of corporate existence, that is, from the conception of the corporation as an artificial entity deriving its existence from the state. It is reasoned that the corporation has only such powers as are given it by its creator and thus has no capacity to exceed these powers. Whatever merit this argument may have had at a time when corporations were created by special acts of the legislature, it is abundantly clear today that it has little merit under modern general incorporation acts where persons are free to decide for themselves what the nature of their corporation shall be and what powers it shall have".

Coming to the second ground, namely, illegality, Oleck thinks that it furnishes poor support for the ultra vires doctrine since an ultra vires act as such is not an illegal act.

About the third ground, namely, notice of the limitations on corporate power, Oleck is of the view: "The idea behind this attempted explanation of the doctrine is that third parties who contract with a corporation are on constructive notice of the extent of corporate power and so act at their peril. The suggestion has been made that the existence of this concept of notice may have been in part a result of the misconception of ultra vires contracts as illegal. It is then tempting to apply the criminal law maxim that 'everyone is presumed to know the law'. But, as Professor Stevens has observed, application of the doctrine of constructive notice cannot be supported by analogy to this principle in criminal law since 'ultra vires action is not criminal action'. Another explanation

The justifications for the doctrine of ultra vires being weak, it led to harsh and unjust results when applied literally. The judicial opinion tended to become unfavourable as more and more courts were faced with the inherent injustice of the doctrine. Judges began to include in their opinions expressions such as, that the defence of ultra vires, whether invoked for or against a corporation, was not, favoured by the law, and that it should never be applied where it would defeat the ends of justice, if such a result could be avoided.

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90. contd......

for the existence of the notice concept is the suggestion offered by Stevens that courts evidently misconceived the real purpose served by the legislative requirement that articles of incorporation be filed in a public office, and should have realized that the purpose to be served by such filing is not to charge thepublic with knowledge as in the case of ordinary recording acts, but rather is to provide a public record of information available to those who may wish to ascertain the data contained in the papers so filed. Moreover, from the practical standpoint, the use of the constructive notice concept has been found particularly objectionable. In the first place, the point has been made that it is unrealistic and contrary to actual business practices to suppose that persons dealing with a corporation can be expected to know the contents of the articles of incorporation. In the second place, it has been observed that even if such persons actually did acquire such knowledge, they would be subject at their peril to deciding whether given action does or does not come within the enumerated purposes or powers of the corporation. Since such decisions often cannot be made with assurance even by lawyers, it is obviously asking much of the business man to shoulder the responsibility for such decisions in his dealings with corporations". (Emphasis added).

Coming to the fourth ground, namely, public policy, Oleck expresses the view: "This argument has appeal, and to the extent that the particular contract is illegal as well as ultra vires, there may well be a public policy

The judges followed up these expressions in practice, and wherever justice demanded, introduced modifications in the application of the doctrine. "It became well settled that a fully executed ultra vires contract would be left untouched. This position was accepted even by those courts which had adopted the 'federal rule', however illogical this may have been under the view that in ult#a vires contract is void. In the interest of security of titles, the courts also uniformly agreed that no attack should be permitted on

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90. contd.......

which is best served by treating the contract as void, but it has been observed that, if the only objection to the contract is the lack of authority on the part of the corporation to enter into such a contract, then it may be questioned whether there is any public welfare which is served by striking down the contract, particularly when the corporation could receive the necessary authority by simply amending the articles of incorporation. Instead, the real public policy, it is argued, seems to point in the direction of upholding the sanctity of contract in commercial transactions" (Emphasis added)

Coming to the last of these grounds, namely, the protection of the rights of stockholders, Oleck thinks that this ground "probably furnishes the strongest argument that can be made in support of the ultra vires doctrine under modern incorporation procedure which, through its flexible provisions, minimizes the outside public interest and emphasizes the specific interests of the inside group of associates. However, while it may be conceded that the inside associates, in their role as stockholders, have a real and active interest in the corporation confining its activities to those specified in the articles, yet as between such persons and those who have dealt with the corporation in good faith with no reason to suspect the transaction is unauthorized, there are strong reasons for placing the risk on the insiders rather than on the innocent third

a corporation's title to property acquired in an ultra vires transaction. Furthermore, as to those contracts which had been executed on one side only, a majority of the state courts took the position that the contract should be enforced at the instance of the party who had performed, at least if the benefits of the performance had been received by the other contracting party. It was said that the nonperforming party was 'estopped' to set up the plea of ultra vires. The courts following the 'federal rule', although unwilling to permit recovery on the contract, were willing to concede a recovery in quasi-contract by the performing party based on the value of any benefits received by the other contracting party as the result of performance".[91]

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90. contd.......
parties. It has been persuasively argued that such a business risk would be placed on an individual principal under the law of agency, as well as on partners under the law of partnership, and that there seems to be no good reason for applying a different principle to stockholders in the case of a corporation".

91. <u>Ibid</u>., at pp. 644-646.
Speaking about the waning influence of the doctrine of <u>ultra vires</u>, Baker and Cary in <u>Cases and Materials on Corporations</u>, pp. 360-361 (3rd ed. 1958), express the opinion: "The declining role of ultra vires in fact represents the history of the business world's struggle to throw off the restrictions imposed upon it. The courts have never fully yielded to the demand of many legal theorists that the concepts of 'corporate powers' and 'ultra vires' be abandoned in favour of a more practical or realistic approach . . . . Instead, the doctrine has been hedged by exceptions and restrictions. The consecutive steps taken by the courts and legislature in yielding to the demands that the doctrine of ultra vires be eliminated are an interesting example of the basic interplay between legal doctrine and societal demands".

Furthermore, unlike Anglo-Indian position, most American courts held that an ultra vires contract could become binding on the corporation by the ratification, assent or acquiescence of all the shareholders, unless the public or the creditors were prejudicially affected.[92] And in making inroads on the citadel of the doctrine of ultra vires, the Supreme Court of Kansas went the farthest when it held in Harris v. Independence Gas Co.,[93] that neither party to even an executory contract should be allowed to defeat its enforcement by a plea of ultra vires. This appeared to be in recognition of the demand that the law ought to give remedies for the enforcement of purely executory ultra vires contracts, in order to ensure to the parties the actual fruits of their bargains, rather than to allow either party to repudiate them upon discovering the probability of loss.[94]

These judicial modifications of the doctrine of ultra vires, important as they were, could not, and understandably so, remove the rigours of this doctrine except to a limited extent. Hence the need was felt for legislatures to take some steps in this regard.

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92. See Ballantine, Corporations, p. 255 (rev. ed. 1946), and Baker and Cary, op. cit., at p. 363.

93. 76 Kan. 750, 92 Pac. 1123 (1907).

94. See Ballantine, op.cit., p. 249.

The first state to attempt legislation on the subject of *ultra vires* was the state of Vermont, which enacted a statute in 1915. The substance of this statute, still a part of the corporation law of that state, is that any act authorised or ratified by the board of directors is to be regarded as the act of the corporation for which the corporation is to be liable, even though such act may be *ultra vires*, provided that a corporation with authority to do such an act might have been formed under the laws of that state at the time the act was done.[95] This statute does have the merit of protecting the interests of third party plaintiffs in all types of contracts, whether they are wholly executory, partially executed, or fully executed.[96] But this statute, obviously, is not a complete treatment of the *ultra vires* doctrine because while it abolishes the

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95. See Oleck, *op.cit.*, at p. 649.

96. A law which does not protect the interests of third party plaintiffs in all types of contracts is not favoured by eminent American authors. In this regard, Baker and Cary, *op.cit.*, at pp. 370-371, express the opinion: "However, it is generally considered that persons outside the corporation should not have the validity of their contracts endangered by the often unsuspected existence of charter limitations. Such results, it is said, place the policy of limiting corporations to their charter purposes above the policy of rendering business transactions secure. The commentators consider that certainty in commercial dealings should take precedence in such circumstances, pointing out that there is sufficient protection of the interests of shareholders and the state in permitting them to bring actions against the corporation for unauthorized dealings, and in allowing corporations, or shareholders through representative proceedings, to bring actions against directors and officers for damages incurred as a result of their unauthorized acts".

defence in suits brought against the corporation, it says nothing about the defence in suits brought by the corporation. Secondly, this statute fails to recognise or account for the well-established right of non-assenting shareholders to bring a suit against the offending officers or directors either to enjoin threatened _ultra vires_ action or in a representative suit to recover damages resulting from the carrying on of such transactions.[97]

A very big step in the legislative treatment of the doctrine of _ultra vires_ was taken in 1929 as a result of provisions which were added to the corporation statutes of California and which were carried forward, with some modifications, into the new California General Corporation Law of 1931. The essence of these provisions was to abolish completely the defence of _ultra vires_ in litigation between the corporation and third parties.

The pertinent portions are:

> "No limitation upon the business, purposes, or powers of the corporation or upon the powers of the shareholders, officers, or directors, or the manner of exercise of such powers, contained in or implied by the articles . . . shall be asserted as between the corporation or any shareholder and any third person". (98)

And

> "Any contract or conveyance made in the name of a corporation which is authorized or

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97. See Oleck, _op.cit._, at p. 649.

98. Cal. Deering's Corp. Code, section 803(b) as quoted in Oleck, _op.cit._, at p. 652.

> ratified by the directors, or is done within the scope of the authority, actual or apparent, given by the directors, except as their authority is limited by law . . ., binds the corporation, and the corporation acquires rights thereunder whether the contract is executed or wholly or in part executory". (99)

The California law nevertheless states that limitations on authority "may be asserted in a proceeding by a shareholder or the state, to enjoin the doing or continuation of an authorized business by the corporation or its officers, or both, in cases where third parties have not acquired rights thereby, or to dissolve the corporation, or in a proceeding by the corporation or by the shareholders suing in a representative suit, against the officers or directors of the corporation for violation of their authority".[100]

It is thus clear that in California the door has been closed to the plea of ultra vires in litigation between the corporation and third parties. The defence is not even preserved, as in 1927 Ohio Act, against those persons chargeable with actual knowledge of the unauthorised exercise of power. In answer to the question whether ultra vires should remain a defence in such cases, Professor Ballantine, draftsman of the California Act, stated that the stability of commercial transactions militates against going into the matter of knowledge of power and authority. He said that

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99. Ibid., section 803(c) as quoted in Oleck, op.cit., at p. 654.

100. Ibid., section 803(a) as quoted in Oleck, op.cit., at p. 655.

"persons dealing with corporations should be enabled to rely on the authority of the directors and should not have to consult an attorney on the frequently difficult question of whether a transaction is ultra vires or run the risk of proving their ignorance of possible limitations on the authority of the managing board".[101] And further, "Responsibility for exceeding the charter bounds should be placed on the directors. Any inquiry or litigation as to knowledge, actual or constructive, or limitations contained in the articles should be ruled out as a matter of policy as to third parties, as the possibility of such litigation tends to unsettle the validity of legitimate transactions with corporations".[102]

It is significant that Ohio has eliminated from its statute the clause pertaining to knowledge and that the present provision in the new Ohio Corporation Law, effective in 1955, contains a sweeping abrogation of the defence of __ultra vires__ similar to that which appears in the California Act.[103]

Many more states have effected and have been gradually effecting legislative amendments in the doctrine. By the end of 1956, twenty-four jurisdictions had enacted

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101. Ballantine, "Questions of Policy in Drafting a Modern Corporation Law", 19 Cal. L. Rev. 465, 475 (1931), quoted in Oleck, __op.cit.__, at p. 654.

102. Ballantine, __Corporations__, pp. 267-268. (rev. ed. 1946).

103. See Oleck, __op.cit.__, p. 654.

provisions dealing with the doctrine of ultra vires in all its aspects. Two methods of approach are found in the provisions of these twenty-four states. Some provisions treat only the basic theories underlying this doctrine. They leave to the law of agency the determination of the consequences of ultra vires acts in the light of the changed theories. Other provisions do not refer to the legal theories underlying ultra vires but rather specify the consequences of ultra vires acts. They impliedly, rather than expressly, abolish the theories of the doctrine. There are four aspects of ultra vires on which the statutes in these twenty-four jurisdictions take different positions. These concern: (1) the manner in which the rules of agency are to be applied to the board of directors; (2) the right of a corporation to plead ultra vires in an action between it and the other party to a contract; (3) the right of a shareholder to enjoin a continued or threatened ultra vires act; and (4) the right of the state to enjoin such an act.[104]

Other aspects of the doctrine are treated in the same way by all the statutes. Thus, the provisions uniformly abolish three rules: (1) the doctrine of limited corporate capacity; (2) the theory of constructive notice of the contents of articles of incorporation; and (3) the right of a third party to plead that a contract was ultra vires the

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104. See Baker and Cary, op.cit., pp. 370-371.

corporation. These rules are expressly nullified by some of the statutes, impliedly by others. In addition, the provisions uniformly preserve six principles: (1) the liability of corporations for torts committed in the course of _ultra vires_ activities; (2) the validity of _ultra vires_ transfers of title to property; (3) the upholding of wholly executed contracts; (4) the invalidity of acts which are illegal, prohibited or against public policy; (5) the ability of a corporation or shareholders through representative proceedings to recover from its agents damages suffered as the result of their engaging in unauthorised transactions; and (6) the right of the state to cause forfeiture of charters when corporations have engaged in activities beyond their charter purposes. These six rules are expressly preserved by some statutes and impliedly by others.[105]

Thus we see that the United States law in this regard now is far in advance of the Indian Law, and also of the English law so long as the recommendations of the Cohen and Jenkins Committees are not adopted there.

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105. See _ibid._, at p. 371.

CHAPTER 2

CONSEQUENCES OF THE DOCTRINE OF ULTRA VIRES

In the last chapter we have discussed the doctrine of *ultra vires* as it obtains in this country. In the present chapter, it is proposed to concentrate on the consequences flowing from the operation of this doctrine. The consequences are that certain rights arise in favour of the company and its shareholders and certain other rights in favour of the other party. It is, therefore, proposed to examine these consequences under the headings "Rights of the Company and Shareholders under *Ultra Vires* Transactions", and "Rights of the Other Party under *Ultra Vires* Transactions".

RIGHTS OF THE COMPANY AND SHAREHOLDERS UNDER ULTRA VIRES TRANSACTIONS

A company as well as the shareholders have the right to ensure that[1] the company's funds are not spent on *ultra vires* transactions. For this purpose, even one single shareholder

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1. In this connection, Lord Herschell observed: "It cannot be questioned, since the case of *Ashbury, etc. Co. v. Riche* that a company cannot employ its funds for the purposes of any transactions which do not come within the objects specified in the memorandum . . . . The capital may, no doubt, be diminished by expenditure upon, and reasonably incidental to, the objects specified. A part of it may be

may bring a suit for an injunction to restrain the company from the proposed dealing. If it has already been entered into, the directors or other officers responsible for the *ultra vires* deal are liable to restore to the company the money thus spent.[2] It is now to be seen how this liability has been worked out in this country.

In *Jahangir Rastamji Modi* v. *Shamji Ladha*,[3] discussed in the last chapter,[4] it has been seen that Sargent, J. held dealings in shares by the company (in its own shares as well as in shares of other companies) to be *ultra vires*. Besides

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lost in carrying on the business operations authorized. Of this all persons trusting the company are aware and take the risk. *But I think that they have a right to rely on the capital remaining undiminished, by any expenditure outside these limits*, or by the return of any part of it to the shareholders". — See *Trevor* v. *Whitworth*, (1887) 12 App. Cas. 409, at pp. 414-415. (Emphasis added).

2. In this connection, an American author says: "The threatened misuse of the corporate assets may be treated as being an injury to the individual shareholders as beneficiary of trust or a party to the charter contract with the corporation, or as being a wrong to all the shareholders in their corporate capacity and so giving rise to a corporate right of action. Shareholders accordingly may seek an injunction either in their own right or in a representative capacity to assert a right of action which belongs to the corporation. But a shareholder's suit for damages against directors or officers for losses caused by *ultra vires* acts beyond their authority may only be maintained as a representative suit for the benefit of the corporation". — See Ballantine, *Corporations*, p. 258 (rev. ed. 1946).

3. (1866-67) 4 Bom. H.C.R. 185.

4. See text to note 21 of the last chapter.

the two issues on ultra vires, one other issue, namely, the sixth issue, was: "Whether the defendants can in any case be held personally liable".[5]

Sargent, J., held that the directors rendered themselves personally liable to restore to the company the money spent by them on ultra vires purposes. But his Lordship held that the plaintiff had for some time acquiesced in these ultra vires transactions and therefore was precluded from complaining of any of the transactions prior to the meeting on the 2nd July, 1866.[6] It was at this meeting that the plaintiff had expressed his disapprobation of these transactions and it was from this date, therefore, that his acquiescence ceased. But there were two ultra vires transactions even after this date, and his Lordship held the directors personally liable to restore to the company the money spent on these transactions and further ordered that the 312 shares[7] of the company should be transferred into their names in the books of the company.[8]

In Kathiawar Trading Co. v. Virchand Dipchand,[9] also discussed in the last chapter,[10] it has been seen that the

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5. See (1866-67) 4 Bom. H.C.R. 188, at p. 189.
6. See ibid., at p. 201.
7. The payment of the purchase money for these shares was one of these two transactions.
8. See (1866-67) 4 Bom. H.C.R. 188, at p. 202.
9. (1894) 18 I.L.R. Bom. 119.
10. See text to note 38 of the last chapter.

liquidator brought a suit, to recover money spent by the directors on ultra vires purposes, only against one of the five directors. The impugned transactions were held to be ultra vires and it was said that the director was personally liable to restore to the company the money spent on the ultra vires dealing. But he was absolved from liability on the ground of bar of the law of limitation and further on the ground of staleness of the claim of the liquidator.

One thing is not clear about this case and that is as to why did the liquidator sue only one of the five directors. It is true that two of the directors were dead and two others had become insolvent. But in the case of insolvent directors their official assignees and in the case of dead directors their legal representatives should have been joined as defendants along with the sole surviving solvent directors.

Expenditure of company's money on ultra vires purposes is a breach of trust and therefore an action to recover this money survives against the legal representatives. Furthermore, it is also a breach of quasi-contract because the directors are in any case deemed to contract with the company that they will not apply the company's money to ultra vires purposes. Hence in every way the right to recover this money will survive against the legal representatives of the deceased directors under section 306 of the

Indian Succession Act, 1925.[11] Peoples' Bank of Northern India Ltd. v. Des Raj[12] and Peoples' Bank of Northern India Ltd. v. Har Gopal[13] support this conclusion.

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11. Section 306 of the Indian Seccession Act (Act XXXIX of 1925) is as follows:

"All demands whatsoever and all rights to prosecute or defend any action or special proceeding existing in favour of or against a person at the time of his decease, survive to and against his executors or administrators; except causes of action for defamation, assault, as defined in the Indian Penal Code (XLV of 1860), or other personal injuries not causing the death of the party; and except also cases where, after the death of the party, the relief sought could not be enjoyed or granting it would be nugatory".

The Lahore High Court has held in Peoples' Bank of Northern India, Ltd. v. Des Raj, (1935) 5 Comp. Cas. 296 and Peoples' Bank of Northern India, Ltd. v. Har Gopal, (1935) 5 Comp. Cas. 305 that the liability of legal representatives was the same as that of "executors or administrators" under section 306 of the Indian Succession Act, 1925.

12. See note 11 supra. In this case, a suit for damages by the Peoples' Bank against two directors of a local branch on the ground that they had acted in defiance of the rules in advancing money to a near relative of one of them was decreed against the Official Receiver of an insolvent director and the sons, being the legal representatives of the other deceased director. The legal representatives were of course held liable to the extent of assets of the deceased director that might have come in their hands.

13. See note 11 supra. In this case, a suit for damages by the Peoples' Bank against the directors of a local branch on the ground of loss caused to the company owing to the wilful breach by the directors of their obligation as directors in granting loans was decreed against the legal representatives of the deceased director.

Further, in The New Fleming Spinning and Weaving Co. Ltd. v. Kessowji Naik,[14] discussed in detail elsewhere[15] in this thesis, the Bombay High Court held that the estate of a deceased director was liable jointly and severally with the other directors for the losses caused to the company by the appointment of a certain firm as bankers to the company, which firm ought not to have been appointed the bankers. It was pointed out that misfeasance of a director constituted a breach of trust, liability for which did not die with the person but followed his estate after his death. But this case should not be understood as affecting the established rule that proceedings known popularly as misfeasance summonses under section 543 of the Companies Act, 1956 are not available against heirs or legal representatives of a deceased director.[16] The difference between the case under discussion and the rule just mentioned is explained by the fact that the barring of a misfeasance application under section 543 against the legal representatives does not debar the liquidator from seeking his remedy by a regular suit, as was done in this case.

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14. (1885) I.L.R. 9 Bom. 373.

15. See text to note 44 in Chapter 2 of Part II.

16. For example, see Vishwa Pal Sharma v. Sukh Sancharak Co. Private Ltd., (1962) 32 Comp. Cas. 947; Peerdan Juharmal Bank Ltd., In Re., (1958) 28 Comp. Cas. 546; Pattiam Veettil Menokki Sankaran Nambiar v. Official Liquidators, Kottayam Bank, (1946) 16 Comp. Cas. 36; Official Liquidators, Mufassil Bank Ltd. v. Jugal Kishore, (1938) 8 Comp. Cas. 300; and S.B. Billimoria v. Cecilia Mary De Souza, (1926) A.I.R. Lah. 624.

Thus, it is submitted that the liability of a director to restore to his company the money which he has applied to ultra vires purposes does not come to an end with him but follows his legal representatives also after his death.

The rule with regard to this liability of the directors or other officers is so strict that they cannot exempt themselves from liability by virtue of any provision to this effect in the articles of association of, or in an agreement with, or in any other instrument executed by the company. Such a provision shall be void.[17] The position in this regard is similar under English law also.[18]

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17. See section 201(1) of the Companies Act, 1956, which is as follows:

"Save as provided in this section, any provision, whether contained in the articles of a company or in an agreement with a company or in any other instrument, for exempting any officer of the company or any person employed by the company as auditor from, or indemnifying him against, any liability which, by virtue of any rule of law, would otherwise attach to him in respect of any negligence, default, misfeasance, breach of duty or breach of trust of which he may be guilty in relation to the company, shall be void.

"Provided that a company may, in pursuance of any such provision as aforesaid, indemnify any such officer or auditor against any liability incurred by him in defending any proceedings, whether civil or criminal, in which judgment is given in his favour or in which he is acquitted or discharged or in connection with any application under section 633 in which relief is granted to him by the Court".

Ultra Vires acts come under at least two of these, namely, breach of duty and breach of trust.

18. See section 205 of the (English) Companies Act, 1948.

Therefore, it is difficult to understand Buckley's writing in his book[19] and Gower's acceptance[20] of it uncritically that the company in general meeting may validly resolve not to sue[21] the directors for, or to give the directors a release from, their liability for restoring to the company the money spent by them on ultra vires acts. It is submitted that the acceptance of this view would have the effect of making futile section 205 of the English Act or section 201 of the Indian Act if this view is unfortunately found acceptable in India also.

It is further submitted that the only forum which can relieve directors or other officers from this liability is the Court which can do it under section 633[22] of the Companies Act, 1956, but only when it appears to the Court that the director or other officer concerned has acted honestly and reasonably and that having regard to all the

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19. See Buckley, The Companies Acts, p. 862 (13th ed. 1957).

20. See Gower, The Principles of Modern Company Law, p. 90, note 80 (2nd ed., 1957).

21. Similar view was expressed about the company's power in general meeting in regard to liability of directors for negligence in Pavlides v. Jensen, (1956) Ch. D.565. For this view, please see note 16 of Chapter 2, Part III of this thesis. But there also I have expressed my doubt about the soundness of this proposition in view of section 205 of the (English) Companies Act, 1956.

22. Or section 448 of the (English) Companies Act, 1948.

circumstances of the case, including those connected with his appointment, he ought fairly to be excused.[23] As directors or other officers of companies are also human beings and so are fallible like any other human being, it is only proper that they should not be held liable if they have entered into <u>ultra vires</u> transactions as a result of an honest error of judgment.[24]

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23. Section 633 of the Companies Act, 1956 is as follows:

(1) If in any proceeding for negligence, default, breach of duty, misfeasance or breach of trust against an officer of a company, it appears to the Court hearing the case that he is or may be liable in respect of the negligence, default, breach of duty, misfeasance or breach of trust, but that he has acted honestly and reasonably, and that having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused, the Court may relieve him, either wholly or partly, from his liability on such terms as it may think fit:

Provided that in a criminal proceeding under this sub-section, the Court shall have no power to grant relief from any civil liability which may attach to an officer in respect of such negligence, default, breach of duty, misfeasance or breach of trust.

(2) Where any such officer has reason to apprehend that any proceeding will or might be brought against him in respect of any negligence, default, breach of duty, misfeasance or breach of trust, he may apply to the High Court for relief and the High Court on such application shall have the same power to relieve him as it would have had if it had been a Court before which a proceeding against that officer for negligence, default, breach of duty, misfeasance, or breach of trust had been brought under sub-section(1).

(3) No Court shall grant any relief to any officer under sub-section(1) or sub-section(2) unless it has, by notice served in the manner specified by it, required the Registrar and such other person, if any, as it thinks necessary, to show cause why such relief should not be granted.

24. The law in the United States is similar:

"Although there is some conflict of authority, the majority of courts do hold the directors and officers

So far we have discussed the rights of a company and its shareholders as against the company's officers only. We now come to the rights of the company as against other parties.

The most fundamental right of the company[25] from which other rights follow is the right to repudiate the transaction on the ground of its being *ultra vires*.[26] It is stated as a rule that an *ultra vires* transaction is completely void and devoid of any legal effect.[27] But strangely enough, if the company has executed its part of the *ultra vires* transaction, the courts by some ingenuity manage to ensure that the contract as such binds the third party. On the other hand, if the third party has executed his part of the transaction, then alone does the rule of *ultra vires* transactions being completely void hold good and only remedies

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24. Contd.......
responsible at their peril for ascertaining the limits of their authority under the articles at their peril. If they wilfully or negligently exceed charter limitations on their authority they make themselves responsible. But if such excess occurs by mistake without a want of such care as ordinarily prudent directors would exercise, they are not liable". — See Ballantine, *op.cit.*, at p. 261.

25. The shareholders can also bring a suit for repudiation of the transaction on the ground of *ultra vires*. See *Deonarayan Prasad Bhadani* v. *Bank of Baroda*, (1957) 27 Comp. Cas. 223, discussed *infra* in this chapter.

26. In *In re Port Canning Co. Ltd.*, (1871) 7 Beng. L.R.(O.C.) 583, discussed in the last chapter (see text to note 27), we have seen that the company repudiated its duly incurred liability on the ground of *ultra vires*. In *Lakshmanswami Mudaliar* v. *Life Insurance Corporation of India*, (1963) 33 Comp. Cas. 420, to be discussed *infra*, we shall see that the successor to a company was permitted to repudiate on the ground of *ultra vires* a payment duly made by the company.

27. "Where a company does an act which is *ultra vires*, no legal

in rem (e.g., claims to follow and recover specifically any property which could be earmarked as never having ceased to be his property) are made available to the third party.

It is interesting to see the manner in which the courts practically enforce the rights of the company against third parties, as if they are enforcing the *ultra vires* transaction itself. The case of *Ahmad Sait and others v. The Bank of Mysore Ltd.*,[28] also discussed in the last chapter,[29] is in point. It has been seen in the last chapter that it was *ultra vires* the Bank of Mysore to advance money on mortgage and yet it did advance money on mortgage. But still the Madras High Court held that the Bank had the right to sue on the basis of the mortgage and thus to enforce the mortgage. The Court justified this holding on the ground that according to Brice on the *Doctrine of Ultra Vires*, property legally and by formal transfer or conveyance transferred to a company in law duly vested in such company, even though the company was not empowered to acquire such property and because under the Indian law a mortgage was a transfer of interest in immovable property.

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27. contd.......
relationship or effect ensues therefrom. Such an act is absolutely void . . ." — *Lakshmanaswami Mudaliar v. L.I.C.*, (1963) 33 Comp. Cas. 420, at p. 434, discussed *infra*.

28. (1930) 59 M.L.J.R. 28.

29. See text to note 42 of the last chapter.

This case reminds us of a similar device invented by the Indian courts in order to circumvent the rule of invalidity of a minor's contract only when it suited the minor contract only when it suited the minor to evade the rule but not otherwise. Pollock and Mulla in their book have given a good account of this device.[30] This account is to the following effect.

Section 7 of the Transfer of Property Act, 1882, provided that every person competent to contract and entitled to transferable property was competent to transfer such property. But it was not provided anywhere in the Act that a person not competent to contract was incapable of becoming a transferee of property. This circumstance was pressed into service and it was held that though a sale or mortgage of his property by a minor was void, a duly executed transfer by way of sale or mortgage in favour of a minor who had paid the consideration money was not void, and it was enforceable by him or any other person on his behalf. A minor, therefore, in whose favour a deed of sale was executed was competent to sue for possession of the property conveyed thereby.[31]

Thus we find that the Indian courts are inclined to treat the companies at par with minors so far as protection of their interests goes. To give a minor certain one-sided

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30. See Pollock and Mulla, Indian Contract and Specific Relief Acts, under the heading, "Mortgages and sales in favour of minors", pp. 78-79 (8th ed. 1957).

31. See ibid.

privileges because of his infancy is understandable but to give to a company also similar one-sided protection does not stand to reason today when companies because of their resources can utilise and do utilise the services of the best legal brains of the country.[32]

Another case on the right of companies under ultra vires transactions against third parties is Dr. A.Lakshmanaswami Mudaliar v. Life Insurance Corporation of India.[33] This appears to be the first case on ultra vires decided by the Supreme Court. The United India Life Assurance Co. Ltd., hereinafter called "the company", incorporated under the Indian Companies Act, 1882, with the principal object of carrying on life insurance business in all its branches, was registered as an insurer under the Life Insurance Act (VI of 1938) for carrying on life insurance business in India. On

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32. "The strict doctrine of limited capacity, it has been well said, 'gives the benefit to the corporation of the protection of the disabilities of a minor, or of a person non compos mentis, while it is well known that corporations are guided by the best of legal skill much more able to understand and interpret the provisions of their charters than the untrained and unsuspicious public. It makes the ordinary citizen guarantee the corporation and its stockholders against the corporation exceeding its powers, instead of the corporation and its stockholders themselves assuming that responsibility, as they should' Clarke, Callifornia Corporations (1916) 94" — See Ballantine, Corporations, p. 241 (rev. ed. 1946).

33. (1963) 33 Comp. Cas. 420. The judgment of the Court was delivered by Shah, J.

July 15, 1955, at an extraordinary general meeting of the shareholders of the company, the following resolution, amongst others, was passed:

> "Resolved that a donation of Rs. 2 lakhs be sanctioned from out of the Shareholders Dividend Account to the M.Ct. M. Chidambaram Chettyar Memorial Trust proposed to be formed with the object, inter alia, of promoting technical or business knowledge, including knowledge in insurance. Resolved further that the directors be and are hereby authorised to pay the aforesaid sum to the trustees of the aforesaid trust when it is formed".

On the date of this resolution, appellants nos. 2 and 4 were directors of the company, appellant no. 4 being the chairman of the board of directors. On December 6, 1955, five settlors (including the company) executed a deed reciting that the settlors desired to establish a charitable trust for commemorating the name of the late M.Ct.M. Chidambaram Chettyar "befitting his services to various institutions and organisations with which he was connected, and to industry, commerce, finance, art and science in general and the great encouragement he gave to education, training, research and promotion of human relationship".[34]

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34. The objects of the trust were manifold, e.g., to establish and maintain scholarships, stipends, allowances to be awarded to Indian students for prosecuting studies, to provide chairs or lecturerships, to conduct competitions to test proficiency in the art of essay writing or speaking, to promote art, science, industrial, technica[l] or business knowledge including knowledge in banking, insurance, commerce and industry, to establish and

Appellants nos. 2, 3 and 4 were the trustees nominated under the deed of trust, and the first appellant was appointed a trustee under clause 8 of the deed. In persuance of the resolution dated July 15, 1955, the directors of the company said an initial instalment of Rs.5,000 to the trustees and the balance of Rs. 1,95,000 was paid on December 15, 1955. On July 1, 1956, the Life Insurance Corporation Act, 1956, was brought into force. By section 7 of that Act, on the "appointed day", all the assets and liabilities appertaining to the controlled business, i.e., life insurance business of all insurer were to stand transferred to and vested in the Life Insurance Corporation of India. September 1, 1956, was notified as the "appointed day", and on that day all the assets and liabilities of insurers including this company stood transferred to and vested in the Life Insurance Corporation.

On September 30, 1957, the Life Insurance Corporation, hereafter referred to as "the Corporation", called upon the appellants to refund the amount of Rs. two lakhs received by the trust from the company in December, 1955,

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34. contd.......
maintain subsidies or support charities in India engaged in improving human relations in industrial or commercial affairs, to establish and maintain or support and educational institution or libraries in India for imparting general, technical or scientific knowledge and to give subscriptions or donations or to render financial assistance to any educational or other charitable institution in India. See (1963) 33 Comp. Cas. 420, at p. 424.

and the appellants by their letter dated December 10, 1957, having denied liability to refund the amount, the Corporation applied on March 14, 1958, to the Life Insurance Tribunal constituted under the Life Insurance Corporation Act for an order that the trustees be ordered jointly and severally to pay to the Corporation the sum of Rs. two lakhs with interest thereon at the rate of 6 per cent. per annum from the date of payment to the trustees.

It was alleged by the Corporation that the resolution dated July 16, 1955, as well as the payments made in pursuance thereof were ultra vires the company and void and of no effect in law; that the memorandum of association of the company did not authorise such payment; that making of such a donation was not in the interests of the Company's business, nor was it a generally recognised method of conducting the business, and by the donation no direct or substantial advantage accrued to the company.

The appellants by their writing statement submitted that the directors of the company were authorised by the articles of association of the company to make donations towards any charitable or benevolent object or for any public, general or useful object; that the amount of Rs. two lakhs was paid out of the Shareholders' Dividend Account which was distinct and separate from the general assets of the company, and under the articles of association money standing to the credit of this account being the exclusive

property of the shareholders and not of the company was held by the company for and on behalf of the shareholders and in trust for them; that the shareholders had absolute right of disposal over the said account and the shareholders of the company having resolved to donate Rs. two lakhs to the trust out of that account in exercise of their absolute ownership and power of disposal over the said fund, the payment could not be called in question by the company or by any body purporting to act on behalf of the company, for if the company had not been taken over by the Corporation, the impugned payment could not have been challenged as ultra vires, and the powers of the Corporation were not larger in ambit and scope than those of the company. The appellants also contended that as trustees they were not personally liable to refund the amount claimed.

By order dated December 20, 1958, the Life Insurance Tribunal directed the appellants to pay jointly Rs. two lakhs within 15 days from the date of service of the order, and in default to pay interest thereon at the rate of 6 per cent. per annum till the date of realisation. Against this order, the present appeal before the Supreme Court with special leave was filed.

Sub-clause (ii) of the Objects Clause authorised the company "to invest and deal with funds and assets of the company upon such securities or investments and in such

manner as may from time to time be fixed by the articles of association of the company". Article 93(t) invested the directors with authority to establish, maintain and subscribe to any institution or society which may be for the benefit of the company and to "make payments towards any charitable or any benevolent object, or for any general public, general or useful object".

The Supreme Court held that sub-clause (ii) of the Objects Clause and article 93(t) of the articles of association, could not be interpreted to give to the directors the authority to spend company's money on any charitable or general object which the directors might choose but they gave to the directors the authority to spend on such charitable or general objects, the promotion of which was conducive to, or useful for, the attainment of the object specified in the objects clause, namely, the business of life insurance in all its branches. Then examining the question whether this trust was conducive to or useful for the business of life insurance in all its branches, their Lordship came to the conclusion that, notwithstanding the fact that one of the objects of the trust was promotion of business knowledge in insurance, the trust could not be said to be conducive to or useful for the business of life insurance.[35]

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35. The judgment said: "The trust has numerous objects one of which is undoubtedly to promote art, science, industrial, technical or business knowledge including

The English decision of Tomkinson v. South Eastern Rly. Co.,[36] was particularly relied upon for this conclusion. Without making any conjectures about the final outcome, I think it would have been better if the attention of the Court was also drawn to the English case Evans v. Brunner, Mond and Co. Ltd.,[37] to which, it appears, their attention was not

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35. contd.......
knowledge in banking, insurance, commerce and industry. There is no obligation upon the trustees to utilise the fund or any part thereof for promoting education in insurance and even if the trustee utilised the fund for that purpose, it was problematic whether any such persons trained in insurance business and practice were likely to take up employment with the company. Thus the ultimate benefit which may result to the company from the availability of personnel trained in insurance, if the trust utilises the fund for promoting education, insurance, practice and business, is too indirect, to be regarded as incidental or naturally conducive to the objects of the company". — See (1963) 33 Comp. Cas. 420 at p. 433.

36. (1887) 35 Ch. D. 675.

37. (1921) 1 Ch. 359. In this case, the distribution of a certain sum of money to such universities and scientific institutions as the directors might select for the furtherance of scientific education and research was held to be expenditure, substantial and direct, and not speculative or too remote, and conducive and necessary for the continued progress of a company formed to purchase and carry on the business of chemical manufacturers.

About this case, the Company Law Committee in England, popularly known as the Jenkins Committee, observed: "If a company has no express power to make donations, it may nevertheless do so if they can reasonably be regarded as benefiting the company. This was established by Evans v. Brunner, Mond and Co., Ltd., (1921) 1 Ch. 359 where a donation for scientific research by Brunner, Mond and Co., Ltd., who were chemical manufacturers, was held to be intra vires. Since that case was decided in 1921 the practice, which has developed, of companies (without expres powers) making donations to general charities of no direct interest to the companies' business has never been

drawn. It should further be remembered that the donation to the trust in this case was made before the Companies Act, 1956, which for the first time[38] introduced into the company law of this country the provision embodied in section 293(1)(e), which permits the Board of Directors of a public company or of a private company which is subsidiary of a public company, with the consent of the company in general meeting to contribute any amount to charitable and other funds not directly relating to the business of the company or the welfare of its employees.[39]

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37. contd......
challenged in the Courts in this country and we venture to think that this practice, which is regarded by businessmen as necessary to create or preserve goodwill for their companies, would, on that ground, be acceptable to the Courts today" — See Report of the Company Law Committee, 1962, Cmnd. 1749, para 52, p.17. Emphasis added.

38. The Indian Companies Act, 1913 or any prior Indian Companies Act did not have any such provision.

39. The position in the United States is as follows:

"It is undoubtedly the orthodox view that the function of the business corporation is profit and that it is therefore improper for it to spend money or engage in activities not entered into with a view to profit. This does not mean that it cannot properly take a long-range rather than a short-range view, and adopt policies in dealing with its employees, its customers or the community at large which, although not immediately profitable, are likely to be helpful in the long run. . . .

"A broader view of the proper purposes of business corporations, particularly of those large corporations whose activities vitally affect the community, is, however, frequently urged at the present time. The only situation in which the broader outlook seems to have had a definite impact on the law is with respect to corporate gifts to charity. The current trend toward liberalizing the power to make contributions stems in no small part from the Interval Revenue Code (section 170), which permits

In view of section 293(1)(e), it is submitted that a company with equivalent provisions in the memorandum and articles could, after the coming into force of the Companies Act, 1956, validly donate any amount, which the shareholders specify in their resolution, to a trust like the one involved in this case. The Parliament has, by enacting this provision, amply shown its desire to enable and encourage companies, the repositories of nation's wealth, to contribute lavishly to

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39. contd.........

a deduction not exceeding twenty per cent. of tax payer's gross income. Furthermore, the concentration of a large proportion of the wealth of community in the hands of business corporations has made corporate gifts essential if charities are to be privately financed. The courts have, generally speaking, been liberal in finding most corporate gifts to public charities to have a sufficient business purpose to be validated . . . .

"Legislatures have authorized business corporations to make donations to charities or other civic enterprises. Most of these statutes omit any requirement that the donation be one which is likely to benefit the corporation in the long run . . . . A.P. Smith Mfg. Co. v. Barlow, . . ., 39 A.L.R. 2d 1179 (1953), perhaps best demonstrates which do not directly benefit the donor. The company having made a gift to Princeton University, plaintiff shareholder questioned its validity. The court had no hesitation in upholding the constitutionality of the new Jersey statute permitting charitable contributions but went further, finding, 'that it was a lawful exercise of the corporation's implied and incidental powers under common-law principles'. It pointed out that the gift was not made 'indiscriminately or to a pet charity of the corporate directors in furtherance of personal rather than corporate ends. On the contrary it was made to a preeminent institution of higher learning'". — Baker and Cary, Cases and Materials on Corporations, under the heading, "Areas of Considerable Retained Ultra Vires Vitality", pp. 366-367 (3rd ed. 1959).

the promotion of education and research. Now it is for the courts to permit this provision to be exploited to the maximum for the nation's benefit.[40]

To resume our main narrative of the decision of this case, the Supreme Court, for the reasons given above, held:

> "We are, therefore, of the view that the resolution donating the funds of the company was not within the objects mentioned in the memorandum of association and on that account it was _ultra vires_. Where a company does an act which is _ultra vires_, no legal relationship or effect ensues therefrom. Such an act is absolutely void and cannot be ratified even if all the shareholders agree . . . . _The payment made pursuant to the resolution was therefore unauthorised and the trustees acquired no right to the amount paid by the directors to the trust_". (41)

The only question which still remained to be considered was whether the appellants were personally liable to refund the amount paid to them. In this regard, the Supreme Court held:

> "Appellants Nos. 2 and 4 were at the material time directors of the company and they took part in the meeting held under the chairmanship of the fourth appellant in which the resolution, which we have held ultra vires, was passed. As office bearers of the company responsible for passing the resolution, _ultra vires_ the company, they will be personally liable to make good the amount belonging to the company which was unlawfully disbursed in pursuance of the resolution". (42)

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40. See also P.S. Sangal, "March of Company Law in 1963", (1965) 2 Comp. L.J. 21, at pp. 22-23.

41. (1963) 33 Comp. Cas. 420, at pp. 433-434. Emphasis added.

42. _Ibid._, at p. 434.

And further:

> "The amount was, it is common ground, not disposed of before the Corporation demanded it from the appellants, and if with notice of the infirmity in the resolution, the trustees proceeded to deal with the fund to which the trust was not legitimately entitled, in our judgment, it would be open to the Tribunal to direct the trustees personally to repay the amount received by them and to which they were not lawfully entitled". (43)

For these reasons, the Supreme Court dismissed the appeal.

Thus the Supreme Court upheld the company's right (for it was the company's right to which the Corporation succeeded) to recover from the trustees even personally,[44] if necessary, the money which the directors had paid to the trustees in pursuance of a resolution which the Supreme Court held to be _ultra vires_.[45]

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43. _Ibid._
44. The position under English law is stated by Gower, _op.cit_ at p. 91, "It is clear, however, that he is liable to restore anything received from the company on the _ultra vires_ transaction so long as it can be traced; indeed he may be under an obligation _in personam_ to restore the equivalent of what he received whether or not he still retains it".
45. As has already been seen (see text to note 42, _supra_), trustee appellants nos. 2 and 4, who were also directors of the company at the material time and who took part in the meeting held under the chairmanship of the 4th appellant, in which the _ultra vires_ resolution was passed, were besides held personally liable in that capacity also.

Having discussed the rights of the company and its shareholders under ultra vires transactions, we now come to the rights of the other party under ultra vires transactions.

RIGHTS OF THE OTHER PARTY UNDER
ULTRA VIRES TRANSACTIONS

We have written above[46] that a company's right to repudiate a transaction on the ground of ultra vires is well-established. The question now arises, does the other party also have the right to repudiate the transaction on the ground of ultra vires.

Before coming to the Indian position, it will be instructive to look to the English position in this regard. The opinions on this question in England are divided. Street thinks that the other party can not plead ultra vires.[47] Gower says the position is not clear but still he thinks that x on principles, possibly the other party may not be able to set up ultra vires.[48]

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46. See text to note 36, supra.

47. "The plea of ultra vires may always be taken by the corporation guilty of the impugned transaction whether such corporation be plaintiff or defendant, and no estoppel will preclude the plea. But the doctrine having been enunciated as a weapon of defence for the protection of corporations, no other party can take the plea as a defence against it".— H.A. Street, A Treatise on the Doctrine of Ultra Vires, p. 30 (1930). Emphasis added.

48. "It is not clear whether the other party when sued by the company can plead as a defence that the contract was ultra vires. On normal principles of the law of contract

On the other hand, Furmston in a well-reasoned article on this point, says: "It is submitted therefore that since the effect of the ultra vires doctrine is to render the contract void and not merely voidable or unenforceable, and

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48. contd.....

he should not be able to set up the incapacity of the person with whom he has contracted, but whether this applies in cases of ultra vires is obscure". — Gower, op.cit., at p. 91.

About this view of Gower, Furmston in an article (see next note) says: "Professor Gower suggests that normal principles of contract law would point against the other contracting party being able to set up ultra vires. This point is not developed but it would seem that he has in mind a case such as infancy, where the infant's incapacity is said to be a personal privilege and cannot be relied upon by the other party. A number of answers may be made to this argument. In the first place the rules relating to the contractual capacity of infants are themselves fraught with possibilities for injustice and may be thought to provide an insecure basis for argument by analogy. Nor is it easy to appreciate the logical basis of the personal privilege argument. If the infant's promise is not binding upon him it is difficult to see what consideration he gives for the other party's promise. It may be that depite the logical difficulties and periodic injustices which they cause, the rules as to infants can be justified by an over-riding need to protect infants but it is fanciful to seek to justify the creation of similar problems in the case of companies by a need to protect companies. Experience has surely shown that it is persons who contract with companies who need protection and to hold that a company can enter into ultra vires transactions knowing that it can disown them if they turn out unfavourable and enforce them if they prosper is, in the words of Fletcher Moulton, L.J., 'to put a huge premium upon a company acting ultra vires, for it would enable it to acquire assets for the benefit of its members without the obligation or even the power to give consideration for them'. Re Birkbeck Permanent Benefit Building Society, (1912) 2 Ch. 183, at 232". — 24 Mod. L.R. 715, at pp. 717-718 (1961).

since this is insisted on to the extent that neither judgment by consent nor ratification by all the shareholders can render it valid, it should follow that neither party is able to enforce the contract".[49] Cheshire and Fifoot bodily adopt this statement to say: "Although it is thus well established that a corporation can plead the defence of ultra vires when sued for breach of contract, opinions differ as to whether the defence is open to the other party to the contract if he is defendant to the action. It would seem on principle that it should be available to him, for. . ."[50]

Furmston concludes his article with the words: "It is submitted therefore that both principle and authority point unequivocally to the conclusion that either party to a contract may set up the defence that the contract is ultra vires".[51]

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49. M.P. Furmston, "Who can plead that a Contract is Ultra Vires?", 24 Mod. L.R., 715, at p. 718 (1961).

50. Cheshire and Fifoot, The Law of Contract, p. 366 (6th ed., 1964). Emphasis added. After the word "for" at the end, the learned authors quote Furmston's statement quoted above in the text from the words "since the effect . . ."

51. 24 Mod. L.R. 715, at p. 720 (1961). While arriving at this conclusion, Furmston relies, inter alia, on Central Transportation Company v. Pullman's Palace Car Company and on the following statement of Gray, J., in this case:

"A contract of a corporation, which is ultra vires in the proper sense, that is to say, outside the object of its creation as defined in the law of its organisation, and therefore beyond the powers conferred upon it by the legislature, is not viodable only, but wholly void, and of no legal effect. The objection to the contract is, not merely that the corporation ought not to have made it, but that it could not make it. The contract cannot be ratified by either party, because it could not have

Further, Salmon, J., in Anglo-Overseas Agencies Ltd. v. Green,[52] though his Lordship felt that the "defendants as champions of this rule have cast themselves in a novel and perhaps not overwhelmingly attractive role",[53] nevertheless proceeded to hear the other party's defence of ultra vires on its merits. If the other party did not have the right to plead ultra vires in defence, Salmon, J., could have said so straightaway and had no need to take the pains of deciding the issue of ultra vires on merits.[54]

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51. contd.......
been authorised by either . . . when the contract is beyond the powers conferred upon it by existing laws, neither the corporation, nor the other party to the contract, can be estopped, by assenting to it, or by acting upon it, to show that it was prohibited by those laws".— 139 U.S. 24, at p. 59; 35 L. Ed. 55, at p. 68 (1890). (Emphasis added by Furmston).

52. (1960) 3 W.L.R. 561. In this case, the company claimed damages against the defendants, an architect and firm of estate agents, alleging, inter alia, breach of contract by the defendants, to assist and render certain services in connection with the obtaining by the company of a building lease of a site in a shopping centre for large store, shops and business development. The defendants denied the company's allegations and further objected that the carrying on of any such business and the making of any such contract would be ultra vires the company and the objects for which it was established. Salmon,J., on the trial on merits of the preliminary issue whether the contract alleged was ultra vires the plaintiff company, held that the making of the contract alleged, was not ultra vires the company.

53. See ibid., at p. 565.

54. The position under the common law of the United States can, besides the passage from the American case quoted in note 51, supra, be gathered from the following passages taken from American treatises:

"The protection of the shareholders may be a sufficient ground to enjoin the corporate agents from applying the funds to purposes foreign to the authorised business.

Now coming to the Indian position, we have seen in the last chapter that there are two cases in which the plea of ultra vires was raised by the other party defendants and the respective courts did not object to the raising of this plea.

In Ahmad Sait and others, v. The Bank of Mysore Ltd.,[55] one of the pleas raised was that the memorandum of association of the plaintiff Bank prohibited the Bank from lending on mortgage, and that the suit transaction was therefore void, as being ultra vires, and not enforceable at the instance of the plaintiff. The Madras High Court did not reject this defence outright but proceeded to meet it on merits.[56]

In Imperial Bank of India Ltd. v. Bengal National Bank Ltd.,[57] the Imperial Bank of India Ltd. claimed against the Bengal National Bank Ltd, which was in liquidation, a

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54. contd......
If the corporation has a defence, the other party also may plead ultra vires, for in a bilateral contract there must ordinarily be mutuality of obligation". — See Ballantine, op.cit., at p. 249. Emphasis added.

"Criticism of the ultra vires doctrine has been advanced mainly against two aspects of the rule: that which permits either party to use it as a defence to defeat a contract which is wholly executory, and that which, in some jurisdictions, permits the defendant to defeat a contract executed by the party bringing the action, though executory on the part of the other". — See Baker and Cary, op.cit., at p. 370. Emphasis added.

Therefore, under the American common law, the other party is, without any doubt, entitled to plead ultra vires.

55. (1930) 59 M.L.J.R. 28. See text to note 42 of the last chapter.

56. See text to note 42, et.seq., of the last chapter and text to note 28, et.seq., supra.

57. A.I.R. 1930 Cal. 536. See text to note 46 of the last chapter.

declaration that two debentures constituted charges upon all the undertakings, property and assets of the defendant Bank and that the debentures might be enforced by the sale of the property and the assets of the defendant Bank. The claim was resisted by the defendants, _inter alia_, upon the ground that the issue and the acceptance of the debentures in question were _ultra vires_ the memorandum of the defendant Bank and were also _ultra vires_ the plaintiff Bank. The Calcutta High Court did not reject outright the plea of _ultra vires_ of the plaintiff taken by the defendant, but proceeded to examine it on merits.

These cases show that in this country, theoretically[58] at least, the other party also has the right to raise the plea of _ultra vires_. This is only proper. Although it is not denied that the plea of _ultra vires_ is obnoxious because it tends to render business transactions insecure, but if this plea is permitted to the company, propriety demands that it should be permitted to the other party also.

The question which arises next is what are the other rights and remedies of the third party under _ultra vires_ transactions.

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58. In practice, the Indian courts nullify this right of the other party by circumventing his plea of _ultra vires_ in some ingenious manner. For an example, see text to note 28, _et.seq._, _supra_.

Three Indian cases have made the following pronouncements in this regard.

In In re the Madras Native Permanent Fund, Ltd.,[59] Venkatasubba Rao, J., of the Madras High Court declared: "The short question I have to decide is, are the amounts due to them debts? In other words, are the lenders, in the eye of the law, creditors and is the borrowing company debtor? This point is now well settled by authority. Where the carrying on of a business by the company was ultra vires it was held that the ultra vires transactions created no debt, either legal or equitable . . . . The relation between the depositor and the company is not that of debtor and creditor and the only possible remedy for the person who has paid the money is one in rem and not in personam".[60]

In Deonarayan Prasad Bhadani v. Bank of Baroda, Ltd.,[61] Justice Desai of the Bombay High Court observed: "The authorities treat as well-established, the broad principle, that if a company borrows money and creates a security on its property when it has no power to do so no debt arises, either at law or in equity, and the lender cannot recover the money in an action in personam, nor can he enforce the security. The position, however, is different and requires to be distinguished where although the borrowing being unauthorised is ultra vires,

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59. (1931) 1 Comp. Cas. 256.

60. Ibid., at p. 260. Emphasis added.

61. (1957) 27 Comp. Cas. 223.

the money so borrowed is applied in the discharge of legal debts and liabilities of the company. In such a case although the security cannot be enforced as such, the quasi-lender may say, not without justification, that the liabilities of the company having remained in substance unchanged he should on general principles of equity not be deprived altogether of the benefit of the security and should in any event be permitted to hold on to what was in fact given to him".[62]

And in In re Port Canning Co. Ltd.,[63] Phear, J., of the Calcutta High Court had said: "The mere drawing of the return bill does not affect the character of the relations between the consignee and the company; and putting this document on one side, we see at once that the right of the consignee to claim repayment of any portion of the money expended in honoring the bills turns entirely upon the terms, express or implied, of the contract of shipment, and the extent to which he had complied with them . . . . It is manifest that a course of proceeding like this, if it were practicable, would absolutely nullify the operation of the doctrine of ultra vires. And still less, as I think, can the consignee claim from the Company the whole amount paid by him on the original drafts, irrespective of the money realized by him, through sale of the goods? It seems to me there is

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62. Ibid., at p. 247. Emphasis added.

63. (1871) 7 Beng. L.R. 583 (O.C.)

no mean between the alternatives of making the Company responsible for the whole of this trading transaction, and holding it free of every part of it . . . . Under these circumstances the consignee is without any way of recourse to the Company itself, whatever remedy he may be entitled to he must seek against the directors personally".[64]

These pronouncements clearly show that the other party does not have a right against the company in personam,[65] but on grounds of justice and fair-play he is given certain

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64. Ibid., at p. 601-602. Emphasis added.

65. "To hold that a remedy will lie in personam against a statutory society, which by hypothesis cannot in the case in question have become a debtor or entered into any contract for repayment, is to strike at the root of the doctrine of ultra vires as established in the jurisprudence of this country. That doctrine belongs to substantive law and is the outcome of statute and cannot be made different by any choice of form in procedure .... I think it excludes from the law of England any claim in personam based even on the circumstance that the defendant has been improperly enriched at the expense of the plaintiff by a transaction which is ultra vires. All analogies drawn from other systems, such as that of Roman law, appear to me to be qualified in their application by two considerations. The first is that, broadly speaking, so far as proceedings in personam are concerned, the common law of England really recognizes (unlike the Roman law) only actions of two classes, those founded on contract and those founded on tort. When it speaks of actions arising quasi ex contractu it refers merely to a class of action in theory based on a contract which is imputed to the defendant by a fiction of law. The fiction can only be set up with effect if such a contract would be valid if it really existed . . . . The second consideration is that where an Act of Parliament imposes a restriction on capacity, that restriction is binding in equity as much as at law, the principles of which equity follows". — Viscount Haldane, L.C., in Sinclair v. Brougham, (1914) A.C. 398, at pp. 414-415.

rights which are in the nature of rights in rem[66] so far as they confer remedies against the company.

The first of these three cases laid down that the other party in an ultra vires loan transaction had the right to trace his money into the funds in possession of the company.[67]

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66. "Accepting the principle that no action or suit lies at law or in equity to recover money lent to a company or association which has no power to borrow, the question remains whether the lender has any other remedies. On this point the result of the authorities may be stated as follows: First, it appears to be well settled that if the borrowed money be applied in paying off legitimate indebtedness of the company or association (whether the indebtedness be incurred before or after the money was borrowed), the lenders are entitled to rank as creditors of the company or association to the extent to which the money has been so applied. . . .

Secondly, it appears to be also well settled that the lender in an ultra vires loan transaction has a right to what is known as a tracing order. A company or other statutory association cannot by itself or through an agent be party to an ultra vires act. If its directors or agents affecting to act on its behalf borrow money which it has no power to borrow, the money borrowed is in their hands the property of the lender. At law, therefore, the lender can recover the money, so long as he can identify it, and even if it has been employed in purchasing property, there may be cases in which by ratifying the action of those who have so employed it, he may recover the property purchased. Equity, however, treated the matter from a different stand-point. It considered that the relationship between the directors or agents and the lender was a fiduciary relationship, and that the money in their hands was for all practical purposes trust money. Starting from a personal equity, based on the consideration that it would be unconscionable for any one who could not plead purchase for value without notice to retain an advantage derived from the misapplication of trust money, it ended, as was so often the case, in creating what were in effect rights of property, though not recognized as such by the common law". — Lord Parker of Waddington in Sinclair v. Brougham, (1914) A.C. 398, at pp. 440-442.

67. See (1931) 1 Comp. Cas. 256.

The second case laid down that even if the borrowing by the company was _ultra vires_, as the money so borrowed was applied in the discharge of legal debts and liabilities of the company, the quasi-lender had the right to retain the benefit of the security given to him.[68] The last of these cases pointed out that the other party could have a right against the directors personally.[69]

It is now proposed to examine these rights in greater detail.

RIGHT TO A TRACING ORDER

If the other party has advanced a loan to a company which loan is _ultra vires_ the company, the other party does not have a right to recover the money so advanced because an _ultra vires_ loan cannot create any liability of the company.[70] On the other hand, this _ultra vires_ transaction cannot deprive the other party lender of his right to ownership in the money advanced. Therefore the third party has the right to follow his money and to recover it in specie from the possession of the company provided that it can be identified. This right of the third party is known as a right to a tracing order or

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68. See (1957) 27 Comp. Cas. 223.

69. See (1871) 7 Beng. L.R. 583 (O.C.)

70. Conversely, the other party is made liable for an _ultra vires_ borrowing by some device or the other. See, for example, the case of _Ahmad Sait and others_ v. _The Bank of Mysore Ltd._, (1930) 59 M.L.J.R. 25. See _supra_ text to note 25.

the right to trace his property.[71] Common law recognised this right of the third party and enforced it if the money could be identified as such or any asset of the company could be identified as having been purchased out of this money.

But the common law could treat the other party's money as identifiable only so long as it had not become mixed up with other money of the company. If, as was very likely, the other party's money got mixed up with the company's money by being paid into the company's banking account, for common law the money became incapable of identification and therefore impossible of being traced. But equity, with a view to making this right of tracing more effective and far-reaching, looked upon the matter as if the directors or other agents held the borrowed money as a trust fund for the benefit of the other party lender.

Equity found no difficulty in regarding a composite fund as an amalgam constituted by the mixture of two or more funds each of which could be regarded as having, for certain purposes, a continued separate existence. Putting it in another way, equity regarded the amalgam as capable, in proper circumstances, of being resolved into its component parts. This approach coupled with and encouraged by the far-reaching

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71. Please see second para of note 66, supra, for Lord Parker's views in this connection in Sinclair v. Brougham, (1914) A.C. 398.

remedy of a declaration of charge enabled equity to identify money in a mixed fund.[72]

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72. See judgment of the English Court of Appeal (Lord Greene, M.R., Wrottesley and Evershed, L. JJ) in In re Diplock, Diplock v. Wintle (and Associated Actions), (1948) 1 Ch. 465, at p. 520. This was an action by the next-of-kin to recover the money of a testator which was wrongly paid by the executors to some charities under a bequest which was held by the House of Lords to be invalid. The charities had received the payments in good faith. It was held that subject to the qualification that the primary claim of the next-of-kin was against the blundering executors, the next-of-kin had a direct claim in equity to recover the wrongly distributed residuary estate from the charities. This decision of the Court of Appeal was affirmed by the House of Lords under the name, Ministry of Health v. Simpson (1951) A.C. 251.

The Court of Appeal mentioned three matters which their Lordships thought were helpful in understanding the limitation of the common law doctrine and the reasons why equity was able to take a more liberal view. Their Lordships said at pp. 519-520:

"(1) The common law did not recognize equitable claims to property, whether money or any other form of property. Sovereigns in A's pocket either belonged in law to A or they belonged in law to B. The idea that they could belong in law to A and that they should nevertheless be treated as belonging to B was entirely foreign to the common law. This is the reason why the common law doctrine finds its typical exemplification to cases of principal and agent. If B, a principal, hands cash to A, his agent, in order that it may be applied in a particular manner, the cash, in the eyes of the common law, remains the property of B. If, therefore, A, instead of applying it in the authorized manner, buries it in a sack in his garden or uses it for an unauthorized purchase, B can, in the former case, recover the cash as being still his own property and, in the latter case, affirm the purchase of something bought with his money by his agent. If, however, the relationship of A and B was not one which let the property in the cash in B but merely constituted a relationship of debtor and creditor between them, there could, of course, have been no remedy at law under this head, since the property in the cash would have passed out of B into A.

"(2) The narrowness of the limits within which the common law operated may be linked with the limited nature

The principle on which, and the extent to which trust money could be followed in equity was discussed at length by Sir George Jessel, M.R., in In re Hallett's Estate.[73]

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72. contd.....

of the remedies available to it. Specific relief as distinct from damages (the normal remedy at common law) was confined to a very limited range of claims as compared with the extensive uses of specific relief developed by equity. In particular, the device of a declaration of charge was unknown to the common law and it was the availability of that device which enabled equity to give effect to its wider conception of equitable rights.

"(3) It was the materialistic approach of the common law coupled with and encouraged by the limited range of remedies available to it that prevented the common law from identifying money in a mixed fund. Once the money of B became mixed, with the money of A its identification in a physical sense became impossible; owing to the fact of mixture there could be no question of ratification of an unauthorised act; and the only remedy of B, if any, lay in a claim of damages".

73. (1880) 13 Ch. D. 696. In this case, H, a solicitor, who was a trustee for some bonds mixed up trust money (sale proceeds of the bonds) with his own money, by paying the same into his own bank account. To put in figures, he had a balance of £ 1800 in his bank account when he paid in £ 2800 of the trust money. He then continued paying in his own money upto £ 1300, and also drawing out for his own purposes from that account upto £ 2800. At his death, there was thus more money to the credit of the account than the sum of the trust money paid into it, but if the rule in Clayton's case applied, i.e., if the amounts drawn out after the mixing of the funds were set against the earlier items paid in, in order of date, a large portion of the trust money would have gone. It was held that the trustee must be taken to have drawn out (£ 2800) entirely from his own private money (£ 1800 plus £ 1300), and not as under Clayton's case, first from the £ 1800, and secondly from the £ 2800 belonging to the beneficiary. Accordingly, the beneficiary would have a charge on the whole balance of £ 3000 for the whole of £ 2800 of the trust money.

Clayton's case, (1816) 1 Mer. 572, had laid down that when a debtor owing several debts to the same creditor

But the equitable right of tracing into a mixed fund is not confined to cases like the Hallett's case, where the right was asserted against the original mixer who was in a fiduciary relationship to the claimant. The case of Sinclair v. Brougham[74] is understood as having decided that Hallett's case was an illustration of a much wider principle.[75] That principle is

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73. contd.....
made a payment to him, the law would, by presumption, appropriate the payment to the debt earliest in point of date. In other words, in a banking account the items drawn out would be attributed to the earliest items paid in, in the chronological order.

74. (1914) A.C. 398. The contest in Sinclair v. Brougham was between depositors and shareholders in respect of a miscellaneous mass of assets distributable by the liquidator in the winding up of a building society. The deposits had been made, and the assets were used, in connection with a banking business carried on in the name of the society but beyond its powers. Each of the two classes claimed priority over the other. Until the case reached the House of Lords the possibility that they might rank pari passu does not appear to have been considered. The majority of the Court of Appeal affirming Neville, J., gave the shareholders priority over the depositors. Fletcher Moulton, L.J., in his dissenting judgment, held the depositors to be entitled to priority over the shareholders. The House of Lords held that both views were wrong and that on the principle on which Hallett's case was founded, the two classes shared rateably. The House of Lords in this case, while preserving the right of individuals to trace their own money, provided for tracing the aggregate contributions of the two classes as classes. Hallett's case was, of course, based on the right of an individual to follow what he could in equity identify as his own money. The extension of the principle in Sinclair v. Brougham was the obvious and, indeed on the facts, the only practical method of securing a just distribution of the assets. — See judgment of the Court of Appeal in In re Diplock, (1948) 1 Ch. 465, at pp.526-527

75. See In re Diplock, (1948) 1 Ch. 465 (C.A.). Commenting on the judgment of Wynn-Parry, J., (1947 Ch. 716) against which the Court of Appeal was hearing this appeal, their Lordships observed: "The error into which, we respectfully

that one whose money has been mixed with that of another or others may trace his money into the mixed fund (or assets acquired therewith) though such fund (or assets) be held, and even though the mixing has been done, by an innocent volunteer, provided that (a) there was originally such a fiduciary or quasi-fiduciary relationship between the claimant and the recipient of his money as to give rise to an equitable proprietary interest in the claimant; (b) the claimant's money is fairly identifiable; and (c) the equitable remedy available, i.e., a charge on the mixed fund or assets, does not work an injustice.[76]

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75. contd.....

suggest, the learned judge has fallen is in thinking that what, in Hallett's case was only the method (there appropriate) of bringing a much wider-based principle of equity into operation - viz., the method by which a fiduciary agent, who has himself wrongfully mixed the funds, is prohibited from asserting a breach of his duty - is an element which must necessarily be present before equity can afford protection to the equitable rights which it has brought into existence. We are not prepared to see the arm of equity thus shortened". — See ibid., at p. 524. Emphasis added.

76. See In re Diplock, supra. Applying these principles to the cases before the Court of Appeal, their Lordships held the next-of-kin entitled to recover pari passu with the charity in cases where the trust money had been mixed with charity money or where it had been paid into a special account and remained unmixed. But where the moneys received by the charity had not been mixed with moneys of the charity but had been expended on the alteration or improvements of their own assets, as by erecting buildings on their own land, or in discharging debts of the charity secured or unsecured, the trust money could not be disentangled, and their Lordships, being of the view that the equitable remedy of a charge would work an injustice, disallowed the claims of the next-of-kin in such cases.

In the last chapter, in Re Madras Native Permanent Fund Ltd.,[77] we have seen[78] that the Madras High Court enabled the depositors in the Deposit Branch to get back about 75 per cent. of their deposits, even though that Court had held the taking od deposits in Deposit Branch from strangers to the company as ultra vires of the company. This was done on the basis of ultra vires depositors' right to trace their money which happened to be in the possession of the company. Fortunately in that case, the assets of the ultra vires business were kept separate from the assets of the intra vires business of the company. And, therefore, the ultra vires lenders could easily trace their own money without any necessity for the Court to decide any question of priority between the ultra vires lenders and the shareholders.

Having thus discussed the other party's right to a tracing order, we now come to another right of the other party which has been referred to before also.[79]

RIGHT TO RETAIN THE SECURITY ONCE OBTAINED

In this country, Deonarayan Prasad Bhadani v. Bank of Baroda Ltd.,[80] recognised this right of the ultra vires lender[81]

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77. (1931) 60 M.L.J.R. 270; (1931) 1 Comp. Cas. 256.

78. In the last chapter, please see text to note 50, et.seq.

79. See text to note 68, supra.

80. (1957) 27 Comp. Cas. 223, decided by Desai, J. of the Bombay High Court. It is a lengthy judgment running into 29 pages of the Report.

81. For the English view, please see first para of note 66, supra.

In this case, the plaintiffs sued for a declaration that a first English mortgage on its properties and assets, created by defendant no. 2 company (the mills company) on August 31, 1953, in favour of defendant no. 1 bank, to secure repayment of a sum of Rs.25,00,000 advanced to the mills company by defendant no. 1 bank, after a scheme of reorganisation of the mills company was sanctioned by the Bombay High Court under section 153 of the Indian Companies Act, 1913, was ultra vires and of no effect. They also sought the consequential reliefs that defendant no. 1 bank might be ordered to deliver up the mortgage to be cancelled and for a permanent injunction restraining defendant no. 1 bank from taking any action under the mortgage or any steps to enforce and realise the mortgage. Plaintiffs nos. 1 and 2 were shareholders of the mills company, which was a public limited company. Defendants nos. 3 to 5 and 11 to 20 were shareholders of the mills company. Defendants nos. 3 to 10 were directors of the company. All the shareholders supported plaintiffs nos. 1 and 2 in this suit. Plaintiffs nos. 3 and 4 were unsecured creditors of the mills company.

In January, 1953, the financial position of the mills company was far from satisfactory. Several creditors had filed petitions in the Bombay High Court for compulsory winding up of the mills company. The company's liabilities were approximately Rs. 1,00,15,000. The Bank of India Ltd., to whom about Rs.32,00,000 were payable, were secured creditors

holding an equitable mortgage on the properties and assets of the mills company. The directors of the company wanted to reorganise the business of the mills company with a view to retaining the fixed assets intact and paying off the liabilities in course of five years and propounded a scheme or reorganisation. The Bank of India had to be paid off in full before there could be any resuscitation of the mills company and a financial arrangement had been reached between the mills company and Bachhraj and Co. Ltd., whereby the latter had agreed to finance the mills company on certain terms mentioned in an agreement dated April 30, 1953.

After the requisite meetings of creditors and members had considered and approved of the scheme of reorganisation, an order was made by the Bombay High Court on May 13, 1953, on the petition of defendant no. 2 company sanctioning the scheme of reorganisation.

The financing arrangement actually made by Bachhraj and Company Ltd. after the scheme was sanctioned, was not in all respect identical with the financing agreement which was annexed to the scheme. Under the arrangement actually put through by them, the mills company took an advance of Rs.25,00,000 from defendant no. 1 bank, upon the terms and conditions set out in the indenture of mortgage, dated August 31, 1953, on the lands, buildings and machinery of the mills company. They further arranged a cash credit account for the

mills company with defendant no. 1 bank upto a limit of Rs. 25,00,000 and the cash credit was secured by hypothecation of the goods belonging to the mills company including upto Rs. 5,00,000 against stocks in process, chemicals and stores with a stated margin. Both, the loan of Rs. 25,00,000 advanced on the security of the mortgage, and the cash credit account, were guaranteed by Bachhraj and Co. Ltd.

Pursuant to this arrangement defendant no. 1 bank paid to the Bank of India Ltd. a sum of Rs. 6,49,707-7-2 out of the cash credit account and a further sum of Rs.25,00,000. The two amounts were paid to the Bank of India Ltd. by defendant no. 1 bank by two cheques in full satisfaction of the claim of the Bank of India Ltd. against the mill company.

The plaintiffs filed this suit on May 11, 1954. In pursuance of an order of the Court, the defendant bank had been in possession of the mortgaged properties of the mills company since September, 1954. The mills company was taken into liquidation by an order passed by the Court on December 17, 1954. The plaintiffs had been permitted to continue the present suit against the mills company in liquidation.

In their plaint, the plaintiffs had relied on terms and conditions relating to the repayment of the amount under the indenture of mortgage created by the mills company in favour of defendant no. 1 bank and averred that these were material and important terms which contravened the scheme as

sanctioned by the Court. They also alleged that this departure from the sanctioned scheme was extremely prejudicial both to the shareholders and to the unsecured creditors of the mills company. On these grounds, the plaintiffs alleged that the indenture of mortgage executed in favour of defendant no. 1 bank was ultra vires, void, inoperative and of no effect.

Defendant no. 1 bank by its written statement contended that the mortgage in its favour substantially complied with the sanctioned scheme and therefore was not ultra vires the mills company. An alternative contention pleaded by defendant no.1 bank was that even if it be held that the mortgage in its favour was ultra vires the bank having paid off in full the amount of the mortgage debt due by defendant no. 2 company to the Bank of India Ltd., it was subrogated to all the rights of the Bank of India Ltd., against defendant no. 2 company and the properties which were the subject-matter of the equitable mortgage in favour of the Bank of India Ltd. Defendant no. 1 bank had further averred that the right of subrogation had been given to it by the express terms of the indenture of mortgage created in its favour.[82]

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82. In this connection, the Bank had relied on the following clause of the indenture of mortgage:

"And it is hereby agreed and declared that the sum of Rs. 25,00,000 (Rupees twenty-five lakhs) (due by the mortgagers to the Bank of India Ltd. and satisfied by

A further alternative plea raised by defendant no. 1 bank in its written statement was that even if the mortgage in its favour was held to be *ultra vires*, the security given to it ensured for its benefit for the sum paid to the Bank of India Ltd. and it was entitled to enforce the contract in terms of the scheme. This plea was sought to be based on principles of equity.

On the question of *ultra vires*, his Lordship concluded:

> "Therefore, it can be said that although the mode or manner or machinery of repayment actually stipulated by the company was in part beyond the powers of the company, the security is good in so far as the transaction is not in excess of the limitations sanctioned by the scheme. For all these reasons I have reached the conclusion that the transaction of mortgage although defective in some respects cannot be regarded as *ultra vires* the company, and a nullity. It would be strange and mercurial to eliminate the liability in a case of the nature before me on some doctrinaire technicality which is not founded on principle nor vouched by authority". (83)

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82. contd......
payment by the mortgagees as herein above provided) and the interest to accrue due in respect thereof and of every part thereof shall not merge in the equity of redemption of the said lands, hereditaments and premises but shall be considered and, kept on foot as a subsisting charge (should be: 'shall be kept on the footing of a subsisting charge'. See *ibid.*, at p. 242) on the said premises for the benefit of the mortgagees and be vested in the mortgagees in trust for themselves and so as to protect them against all mesne incumbrances, charges and estates if any". — See (1957) 27 Comp. Cas. 223, at p.233

83. See *ibid.*, at pp.241-242. Before arriving at this conclusion, his Lordship observed: "I disclaim any intention to minimise or close my eyes to the scope of

After holding that the mortgage transaction was not _ultra vires_, it was not very necessary for his Lordship to consider the alternative pleas of defendant no. 1 bank. But still his Lordship proceeded to examine them.

Rejecting the plea of subrogation to the rights of the Bank of India Ltd., paid off by defendant no. 1 bank, his Lordship observed:

> "Our law of subrogation enacted in section 92 quoted above requires a loan by a person to a mortgagor and an agreement in writing and registered to the effect that the lender shall be subrogated to the rights of the mortgagee. There must be a loan and there must be an agreement to subrogate. This presupposes that on the part of the mortgagor there must be the capacity to borrow and the capacity to enter into the agreement. But if the transaction itself is _ultra vires_, no debt is created and the loan is entirely void. It is extremely difficult to see how in such a case the _quasi-lender_ can claim to exercise the rights of the motgagee by enforcement of the security created in favour of the mortgagee. If permitted that would in some cases

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83. contd.....

a doctrine established in a stringent form by Acts of the Legislature and decisions of great authority. But the application of the doctrine of _ultra vires_ is not as imperious and as embracing as submitted by the learned counsel for the plaintiffs. That submission seems to me to require the law to function with unmitigated rigour and to have destructive effects not necessitated by any sound principle underlying the doctrine. The main feature and the main facet of the doctrine of _ultra vires_ is that a company having corporate _persona_ should not be mulcted for its own act or an act of its agent if it is beyond its own powers or privileges. The company can have no agent to do that which is beyond the purpose of its creation or to do an act which the company itself was expressly or by necessary implication prohibited from doing". — See _ibid._, at p. 240.

have the effect of placing the quasi-lender
in a better position than he would have been
if the transaction were valid". (84)

Therefore, his Lordship proceeded to consider the last plea raised in the alternative by defendant no. 1 bank that even if the mortgage in its favour was held to be ultra

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84. For this observation, his Lordship relied on para. 3 of section 92 of the Transfer of Property Act, 1882 and on the decision of the English Court of Appeal in In re Wrexham, Mold and Connah's Quay Railway Co., (1899) 1 Ch. 440, particularly on a passage from the judgment of Rigby, L.J., in that case.

Para. 3 of section 92, T.P. Act says: "A person who has advanced to a mortgagor money with which the mortgage has been redeemed shall be subrogated to the rights of the mortgagee whose mortgage has been redeemed, if the mortgagor has by a registered instrument agreed that such person shall be so subrogated".

Rigby, L.J., stated at p. 455: "I think that the great preponderance of authority shews that the doctrine of subrogation has very little, if anything at all, to do with the equity really enforced in the cases, and that there is, at any rate, no authority for any subrogation to the securities or priorities of the creditors paid off. Dealing with this case independently of the authorities, I see no reason why the parties to an illegal lending should have anything more than bare justice dealt out to them; and this they get if they are allowed, as they have hitherto been allowed, to have that portion of the advance actually expended in payment of debts of the company treated as a valid advance. If the advance had been within the borrowing powers of the company, the bank could have had no right to the securities or priorities of the creditors paid off. It seems to me that it would be unjust to other creditors that a fiction should be invented for the purpose of making an invalid loan more valuable than a valid one".

This case decided that where a company borrowed money ultra vires, the lender, so far as the money was applied in the discharge of legal debts and liabilities of the company, was entitled to have the loan treated as valid, but he was not subrogated to any securities or priorities of the creditors who were paid by means of his money.

vires, the security given to it enured for its benefit for the sum paid to the Bank of India Ltd. and it was entitled to enforce the contract in terms of the scheme. This plea was sought to be based on the general principle of equity, that those who paid ligitimate demands which they were bound to meet, and had had the benefit of other peoples' moneys advanced to them for that purpose, should not retain the benefits so as, in substance, to make those other people pay their debts. It was said on behalf of the bank that on the facts of this case the reliefs asked for the plaintiff should not be granted to them even if the transaction between the bank and the mill company was held to be ultra vires the mills company. Moneys were given by the bank and were applied in the full discharge of the liability of the company to the Bank of India Ltd., and the bank held a security on the properties and assets of the company.

The bank was further entitled to go into possession of the property mortgaged to it at any time in case of certain eventualities. The bank had in fact entered into and continued to be in possession. This, it was said, was in any event in the purported exercise of its right to hold the mortgage property as security. Finally, it was urged that the bank, being in fact in possession, and claiming to be mortgagees, there had arisen an equity in its favour which entitled it to resist the plaintiffs' suit. Learned counsel

for the bank very strongly relied on a decision of the English Court of Appeal in Blackburn Building Society v. Cunliffe, Brooks, & Co.,[85] in which a similar equity was upheld.

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85. (1883) 22 Ch. D. 61 C.A. The facts of this case relevant for the present purposes were that a benefit building society, which had no power to borrow money, was permitted by its bankers to overdraw its account by a large amount. Certain deeds of the borrowing members of the society which had been deposited with the bankers were deposited not only for safe custody but also as a security for the balance from time to time due to the bankers. An order for the winding up of the society was made. The official liquidators brought an action claiming a declaration on the ground of ultra vires, that the deeds deposited with the bankers were the property of the society and were not subject to any security in favour of the bankers and asked that the deeds might be delivered up to the plaintiffs. It was held by the Court of Appeal that the overdrawing of the bankers' account was ultra vires the society, and therefore the bankers had no security on the deeds under the agreement with the society. But they were held entitled to hold on to the deeds as a security for such part of the moneys advanced by them as had been applied in payment of the debts and liabilities of the society.

Delivering the judgment of the Court of Appeal (Lord Selbourne, L.C., Jessel, M.R., and Cotton, L.J.), the Lord Chancellor observed: "But there is an equitable principle, consistent with the law of which I have spoken, sound in itself, and also sufficiently established by authority, which may entitle them, nevertheless, to some benefit from their securities; and if the facts of the case give them the benefit of that equitable principle, it is consistent with justice and with authority to say that irregularity of either the form or the substance of their course of dealing shall not stand in the way of the justice due to them. . . . The test is: has the transaction really added to the liabilities of the company? If the amount of the company's liabilities remain in substance unchanged, but there is merely for the convenience of payment, a change of the creditor, there is no substantial borrowing in the result, so

But the counsel for the plaintiffs argued that this equitable principle recognised and applied by the English Court of Appeal in the Building Society's case, was not applicable in India. Reliance was placed on the well-known principle that where there was a statutory provision, the courts should follow the statutory provision and that they were not entitled to extend that provision by having recourse to any rules of equity. The argument went on that the whole law of subrogation in India was to be found in section 92 of the Transfer of Property Act.

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85. contd.....
far as relates to the position of the company. Regarded in that light, it is consistent with the general principles of equity, that those who pay legitimate demands which they are bound in some way or other to meet, and have had the benefit of other people's money advanced to them for that purpose, shall not retain that benefit so as, in substance to make those other people pay their debts. I take that to be a principle sufficiently sound in equity; and if the result is that by the transaction which assumes the shape of an advance or loan nothing is really added to the liabilities of the company, there has been no real transgression of the principle on which they are prohibited from borrowing". — See ibid.,at pp. 70-71.

This case was carried to the House of Lords. The decision of the House of Lords was reported in Cunliffe Brooks & Co. v. The Blackburn and District Benefit Building Society, (1884) 9 A.C. 857, but on this point there was no appeal by the liquidators and the House of Lords did not express any opinion on this part of the decision of the Court of Appeal. The learned Solicitor-General, on behalf of defendant no. 1 bank, however, relied on the following passage from the speech of Lord Blackburn: "The Court of Appeal, in the present case, held that though there was nothing that amounted to an assignment to the bankers of the claims of those who were paid off by the money advanced, yet if it could be shewn that such claims were in fact paid off thereby, there was

His Lordship agreed with the last two arguments but observed:

> "The proposition, however, pressed before me by the learned Solicitor General cannot be regarded as an extension of the doctrine of subrogation. There is no question here of the quasi-lender claiming to step into the shoes of the original mortgagee of the property of the mortgager, nor of his seeking to avail of the security created in favour of the mortgagee. What the quasi-lender seeks to do is to rely on the equity that the company shall not enrich itself with moneys not belonging to it when the moneys were advanced to it by the lender for the very purpose of, and in fact directly utilised in, paying off a pre-existing liability of the company. What the bank contends is that in this state of facts it would be inequitable and against all conscience for the company to benefit by the moneys of the bank and especially when the bank holds a security and is in actual possession of the property on which that security was created. I do not think that the present contention of defendant no. 1 bank is founded on any extended application of the doctrine of subrogation". (86)

According to his Lordship, the proposition that in such a case the quasi-lender should be permitted to hold on to his security was to some extent justified by that equity which, while not prepared to condone any illegality, required the court, as far as possible, to restore the parties to their original position even in cases of transactions *ultra vires* the company.[87] Restitution in such cases was generally

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85. contd......
an equity in substance to give them, the bankers, the same benefit as if there had been such an assignment. This is an important decision. It seems to be justice; whether it is technical equity is a question which, I think, is not now before this House". — See (1884) 9 A.C. 857, at p. 866.

86. (1957) 27 Comp. Cas. 223, at pp. 246-247. Emphasis added.
87. See *ibid.*, at p. 247.

viewed with favour when it could be done without destroying other priorities and without affecting the rights of innocent third parties. Although restitution was by itself a distinct relief, it was not dissociated from cases where substantial relief was claimed by a company on the ground of ultra vires. The extent to which restitution might be granted must of necessity depend on the facts of each particular case.[88]

In his Lordship's opinion, "once the contract goes on the ground of ultra vires, the security also would go, for to hold it and enforce it would be to enforce it against all the world that is against all the creditors and shareholders of the company. The question whether in such a case the security would be enforced in an action brought by the quasi-lender is beset with some doubt and difficulty".[89] His Lordship

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88. In the appeal that was carried to the House of Lords in the case of the Blackburn Building Society (supra note 85), the House of Lords was not called upon to, and, therefore, did not express any opinion on this complicated question. Of course, the judgment of the Court of Appeal dealt with the question of retention of the securities alone and not the fate of a claim at the instance of the bank. In this connection, please see also the judgment of Lord Dunedin in Sinclair v. Brougham, (1914) A.C. 398, at pp. 430-431.

But it does not follow that in England the equity of restitution is necessarily a passive equity. In In re Airedale Cooperative Worsted Manufacturing Society, Ltd., (1933) 1 Ch. 639, Eve, J., held that Congleton Cooperative Society which had advanced loans to Airedale Cooperative Society, which borrowing was ultra vires the latter Society, was entitled to prove for those loans in the winding up of the latter society as that borrowed money was applied in paying the proper debts of Airedale Cooperative Society.

89. See (1957) 27 Comp. Cas. 223, at p. 248.

was, however, not called upon to decide that question in the present case. Here defendant no. 1 bank was not seeking any relief from the court. It was relying on the transaction for the purpose of showing that it was in possession of the property of the mills company. It relied on that possession and said that it was in any event entitled to retain the same. Moreover, it relied on that possession as a shield and not as a sword.

Therefore, the crucial question that arose for determination by his Lordship was whether a quasi-lender, whose money had been applied in discharging a previous equitable mortgage on its property created by a company and who in his turn was in possession of the property of the company given to him in the purported performance of a contract to create security, which contract was a nullity as being _ultra vires_ the company, could claim to retain that property on equitable grounds and say that he could not be compelled to part with it without due restitution? His Lordship thought that the answer to this question must largely depend on the facts of each particular case. In the present case, it could not be said, nor was any such suggestion made by learned counsel for the plaintiffs, that to recognise that right of retention would affect other just priorities or rights of innocent third parties. Nor could it be said with any justification that to recognise that right of retention would make an invalid loan more valuable than a valid one.

His Lordship concluded:

> "For all these reasons I have reached the comforting conclusion that even if I were to take the view that the whole transaction of mortgage in favour of defendant no. 1 bank was *ultra vires* and a nullity, I would yet hold that there is an equity arising in favour of the bank which entitles it to retain possession of the property given to it in the purported performance of the contract between the parties and to claim restitution before it can be compelled to part with possession of that property. Therefore, in that view of the matter also the plaintiffs are not entitled to the relief they seek in this suit". (90)

The suit of the plaintiffs was dismissed in recognition of the right of third party *ultra vires* lender (defendant no. 1 bank in the present case) to retain the security once obtained until duly restituted. This right was not only recognised but also given effect to in this case.

Lastly, we come to the other party's rights against the directors personally.[91]

RIGHT TO PROCEED AGAINST DIRECTORS PERSONALLY

In *In re Port Canning Co. Ltd.*,[92] discussed in the last chapter, we have seen that the payees or endorsees under

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90. The case of defendant no. 1 bank was in the course of the arguments not confined to this limited aspect of the matter but principally was that in any event it was entitled to hold the security and enforce the same in terms of the contract annexed to the scheme sanctioned by the court. See *ibid.*, at p. 249.

91. See text to note 69, *supra*.

92. (1871) 7 Beng. L.R. 583 (O.C.)

the redrafts, who were the claimants in that case, could not recover anything from the company.[93] But Phear, J., who decided that case, nevertheless, pointed out that whatever remedy the third parties might be entitled to, they must seek against the directors personally.[94] It is now proposed to investigate as to what this remedy against the directors is and how it can be enforced.

Apart from the hint in the case[95] last-mentioned that there may be a remedy against directors personally, it appears that there is no Indian case on the point. But there are a few English cases which can usefully be looked to in the absence of Indian material.

In Chery and M'Dougall v. The Colonial Bank of Australia,[96] the Judicial Committee of the Privy Council, affirming judgment of the Supreme Court of Victorial, held two of the directors of a joint stock company personally liable to

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93. See text to note 27, et.seq., in the last chapter.

94. See text to note 64, supra.

95. In re Port Canning Co. Ltd., (1871) 7 Beng. L.R. 583 (O.C.

96. (1869) L.R. 3 P.C. 24. This was an appeal from the Supreme Court of the colony of Victoria. The Judicial Committee of the Privy Council which decided this appeal consisted of Sir James William Colvile, Sir Joseph Napier, and Lord Justice Giffard.

the third party bank on the basis of breach of implied warranty of authority.[97]

Weeks v. *Propert*[98] decided that the defendant director was personally liable for a breach of implied warranty to the effect that the directors had power to issue a valid debenture,

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97. Two of the directors of the company, by a letter to the company's bankers, informed them that they as directors of the company had appointed Mr. Clarke as legal Manager of the company and had authorised him to draw cheques upon the account of the said company. These two directors did not form a majority of the directors of the company and therefore according to their Act of incorporation did not have the authority to bind the company. Although the company's account was at the time overdrawn, and that fact was known to the two directors, the bankers honoured the manager's cheques on the authority so given to them. In an action brought by the bank against the two directors for advances made on account of the company upon the faith of their letter, the Supreme Court of Victoria held that there was an implied warranty on their part that they had the power to bind the company by conferment of authority on the manager which warranty had been breached. Therefore the directors were held personally liable to the bank, and judgment was given to the extent of the sums overdrawn by the manager subsequent to the date of their letter. The Privy Council affirmed this judgment.

Delivering judgment of the Privy Council, Sir Joseph Napier put strong reliance on a statement of Mr. Justice Story made by him in his *Commentaries on the Law of Agency*, chapter X, section 364. Sir Joseph Napier, referring to Mr. Justice Story, said: "According to the opinion of that eminent jurist, if a person represents himself as having authority to do an act when he has not, and the other side is drawn into a contract with him, and the contract becomes void for want of such authority, he is liable for the damage which may result to the party who confided in the representation, whether the party making it acted with knowledge of its falsity or not. In short, says Mr. Justice Story, he undertakes for the truth of his representation". — See (1869) L.R. 3 P.C. 24, at p.31.

98. (1873) L.R. 8 C.P. 427, decided by Keating and Honyman, JJ.

which they did not have as this borrowing was in excess of the borrowing-powers of the company itself. The plaintiff third party was held entitled to recover as against the defendant director £ 500 (which his testator had paid to the company), together with interest by way of damages.[99]

In Chapleo v. Brunswick Building Society,[100] the English Court of Appeal held the directors personally liable

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99. Honyman, J., in the course of his separate judgment said (ibid., p. 439): "Here, however, the defendant, knowing that the power of borrowing money on debentures had been fully exercised by this company, — a fact which was unknown to the person with whom he was dealing, — represented that the directors had power to issue debentures so as to bind the company. I think, therefore, that the defendant was guilty of a breach of warranty. But it was insisted that the plaintiff could only be entitled to nominal damages, because, if the company were insolvent, the debenture would be valueless, and Mr. Weeks would sustain no damage from not getting it; and, if solvent, he would have his remedy against them. If Mr. Manisty could have made out his last proposition, I should have thought that might be so. But I think it lay upon the defendant, who says that the plaintiff had a remedy against the company, to satisfy us that the fact is so; and he has failed to satisfy me that either Walter Weeks or his executor could have had any remedy against the company for the sum advanced".

100. (1881) 6 Q.B.D. 696 C.A. The Court of Appeal which decided this case consisted of Bramwell, Baggallay and Brett, L. JJ. By the certified rules of the Building Society (which was unincorporated), the directors were authorised to borrow money upto a prescribed limit. Loans were made to the society through its secretary in accordance with advertisements, issued with the authority of the directors, that such loans might be so made by bringing the money to the office of the secretary. In each case a receipt was given by the secretary for the money as a loan to the Society, with a written undertaking by him "to procure the promissory note of the directors for the loan", and afterwards, in pursuance of such undertaking, the receipt was exchanged for such note,

to the third party lenders for the money which those lenders had advanced to their Society, on the ground of breach of implied warranty of authority by the directors.[101]

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100. contd.....

which always bore the date of the receipt. After the prescribed limit to the borrowing had been exceeded, the plaintiffs, who had on several previous occasions lent money to the Society according to the above mode, paid a sum to the secretary as a loan to the Society, and received from him the usual receipt and undertaking, but no promissory note of the directors was ever afterwards given, and the secretary absconded with that money.

In an action against the Society and the directors, the lower court held that the Society as well as the directors had represented the secretary to the plaintiffs as having authority to receive the loan on the Society's behalf on the terms on which it was received. The Court of Appeal reversed this decision as against the Society but held that although there was no fraud on the part of the directors, they were personally liable to the plaintiffs for the money which had been so advanced.

101. In the course of his judgment, Brett, L.J., referring to the receipt given by the secretary to the plaintiffs, observed: ". . . it must come to this — it certainly is a representation to the plaintiff Chapleo that his money is lent on loan to the Society, and such representation is made by the authority of the directors. Is not that a representation by them that they have authority from the Society to borrow for the Society? It seems to me that that is the true construction upon that point . . . It must be taken that when the directors represented that they had authority which they had not, by reason of the limit to borrowing having been passed, they nevertheless warranted to the plaintiff Chapleo that they had that authority. Therefore upon that ground they are liable. But if it be taken that it is a promise by them on behalf of the Society that the Society would procure their signatures, then it would seem to me that there again they are representing that they were agents for the Society with an authority which they did not possess. Then they must be taken to warrant that, and therefore . . . these directors are personally liable". — See (1881) 6 Q.B.D. 696 C.A. at p. 717.

Again, in West London Commercial Bank, Ltd. v. Kitson,[102] the Court of Appeal held that the defendant directors were personally liable to the third party bank which discounted the bill of exchange which these directors had accepted on behalf of the company, when the company did not have the power to accept bills. This was so held because, by their acceptance, the directors had represented that they had authority to accept on behalf of the company, which being a false representation of a matter of fact and not of law, gave a cause of action to the plaintiffs, who had acted upon it.

It was strongly urged on behalf of the directors that the company had no power by their Acts of Parliament to accept, and therefore the representation by the acceptance of the bill on behalf of the company by these two defendants as directors was a representation of a matter of law and not of any fact, and consequently formed no cause of action when it was not true. To this, Bowen, L.J. replied: "In the present case it is not a representation of a matter of law. It is a representation as to the powers of a company to accept bills,

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102. (1884) L.R. 13 Q.B.D. 360 C.A. The Court of Appeal which decided this case consisted of Brett, M.R., Bowen and Fry, L. JJ. This was an appeal of Kitson and Porter, two of the defendants from the judgment of the Queen's Bench Division (Day and Smith, JJ.) on a special case. That judgment appeared in 12 Q.B.D. 157.

and that depends on their private Acts of Parliament. Suppose I were to say I have a private Act of Parliament which gives me power to do so and so. Is not that an assertion that I have such an Act of Parliament? It appears to me to be as much a representation of a matter of fact as if I had said I have a particular bound copy of 'Johnson's Dictionary'. It does not fall within those cases in which a man makes an assertion of a matter of law to one who has equal means with himself of knowing what the law is. I think in the present case there was a misrepresentation of a fact and not of a matter of law. . ."[103]

In Firbank's Executors v. Humphreys,[104] the action was brought by Firbank to recover damages from the five defendants, who were directors of a Railway Company. The basis of this action was that the directors had impliedly warranted to him that two certificates for debenture stock of the company were good and valid certificates and were issued under the borrowing powers of the company and that they had as directors authority to issue the certificates to the plaintiff on behalf of the company, whereas these certificates were not valid for having been issued in excess of the borrowing powers of the company and the defendants

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103. See (1884) L.R. 13 Q.B.D. 360, at p. 363.

104. (1886) L.R. 18 Q.B.D. C.A. The Court of Appeal which decided this case consisted of Lord Esher, M.R., Lindley and Lopes, L.JJ. This was an appeal from the judgment of Mathew, J., on the trial of the cause without a jury.

had no authority to issue them. The plaintiff had contracted to construct a railway line for the company and worked for the same, for which he was entitled to be paid in cash. The company not being in a position to pay, an agreement was made during the progress of the works by which the plaintiff agreed to accept debenture stock in lieu of cash. The defendants, who were directors of the company, thereupon issued to the plaintiff certificates for the agreed amount of debenture stock, such certificates being signed by two of the defendants. At that time, although the fact was not known to the defendants, all the debenture stock which the company was entitled to issue had been issued, and consequently that which the plaintiff received was an over issue and valueless. The company subsequently went into liquidation, but valid debenture stock retained its par value.

The plaintiff brought this action to make the defendants personally liable for the value of the debenture stock which should have been issued to him under the agreement. The Court of Appeal held, affirming the judgment of Mathew, J., on the trial, that the defendants were liable on their implied representation that they had authority to issue valid debenture stock which would be a good security, and that under the circumstances the damages were the face value of the stock which the plaintiff would have received under his agreement.[108]

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108. "The next question is as to the amount of damages to which the contractor is entitled. The directors cannot

From this discussion of English cases, we find that in England, the other party to an *ultra vires* transaction has a right to recover damages from the directors personally if he is without a remedy against the company. But for this it is necessary that the warranty of authority, either express or implied, by which the third party is induced to enter into that transaction, should arise by means of a mis-representation of a matter of fact and not of a matter of law. If the misrepresentation is about a matter of law, the other party can have no remedy against the directors. The case of *Rashdall v. Ford*[106] is an illustration.[107]

In this case, the plaintiff alleged, that being desirous of advancing money on debentures, he applied to a secretary of a railway company. The Secretary wrote back,

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105. contd.....

be treated as having warranted the solvency of the company, and if genuine debenture stock of the company had been worthless, the measure of damages would have been nil, but in this case the company's debenture stock is and always has been worth twenty shillings in the pound. Consequently the value of 18,400 £. genuine debenture stock is the measure of the contractor's loss. That is what he agreed to take in satisfaction of a larger demand, and that is what he has lost by reason of the misrepresentation made to him". — per Lindley, L.J., in (1886) L.R. 18 Q.B.D. 54, at pp. 62-63.

106. (1866) L.R. 2 Eq. 750, decided by Sir W. Page Wood, Vice-Chancellor.

107. The other illustrations are *Beattie v. Lord Ebury*, (1872) L.R. 7 Ch. App. 777; and *Eaglesfield v. Marquis of Londonderry*, (1876) L.R. 4 Ch. D. 693 C.A.

offering him a bond of the company for £ 1,500, and stating that the company was not yet in a position to issue permanent debentures, but that they expected to be able to do so in four or five months' time. With the letter was sent a prospectus, from which it appeared that the company was incorporated by Act of Parliament, and that three named persons were its directors. Plaintiff advanced the money, and received in return a Lloyd's bond, signed by the Secretary, whereby the company purported to acknowledge the debt, and to covenant to pay the same with interest at 6 per cent.

The company, being in difficulties, stopped paying interest.[108] The plaintiff filed a bill against two of the three directors, and the representatives of the third, paying that they might be decreed to repay the amount advanced by the plaintiff with interest. Sir W. Page Wood, V.C. held

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108. In April, 1864, the plaintiff received a year's interest, but no more interest was paid, and in November, 1865, he was told that the company could not pay its way; whereupon he consulted his solicitor, who advised him that the so-called bond was not binding upon the company and was, in fact, wholly void. The bill alleged that the grounds upon which the plaintiff's solicitor arrived at this conclusion were, that by the Act incorporating the company, it was enacted that the company might borrow on mortgage any sum not exceeding in the whole £ 20,000; but that no part of such sum should be borrowed until the whole of the capital of £ 60,000 should have been subscribed for, and one-half actually paid, and that the conditions thereby imposed on the company in reference to borrowing money had not been complied with — the facts being, that the whole of the £ 60,000 had not been subscribed for, nor one-half of the capital paid up.

the misrepresentation in this case to be one in regard to a matter of law, to which case, the learned Vice-Chancellor held, the principle of relief on the ground of misrepresentation by third persons did not extend.[109]

On the basis of an examination of all these cases on warranty of authority, Street concluded that the true position perhaps was that an outsider being taken to know the contents of statutes and other public documents could not

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109. The learned Vice-Chancellor observed:

"This bill seeks to make the Defendants stand in the place of the company with which the Plaintiff supposed he was contracting, on the well-known principle that where, by the representations of a third person, a man is led into a contract which proved to be injurious to him, or from which he reaps no fruit, he is entitled to have those representations made good.

"The Plaintiff's case is that He contracted with a railway company who were incapable of contracting. He says, 'The secretary represented to me that they were capable of contracting, and therefore I hold them to be actual contractors.' Now if there had been any misrepresentation of a matter of fact in this case, the result would have been undoubted; as, for example, if the company having power to issue debentures to a certain amount, and having exhausted that power, the directors had stated that they still had power to issue debentures, they would then have stood in the position of being obliged to make good their representations. . . . There is no attempt to allege fraud, or any misleading of an ignorant man. The case is that of two persons of equal knowledge and intelligence. They meet and make a bargain. The Plaintiff alleges a misrepresentation of a matter of law, and that under that state of circumstances, he advanced money to people who were unable to borrow from him — a case extremely analogous to that of a payment made by a man in alleged ignorance of the law. It seems to me impossible to extend the principle of relief arising out of misrepresentation, to a statement of law which turns to be an incorrect statement". — See (1866) L.R. 2 Eq., 750, at p. 754.

complain of any statement as to powers, the correctness of which he could estimate by reference thereto. But if he was misled by statements affecting the operation of such documents, so that knowledge of the law could not help him, then the maker of such statements would be liable on a warranty of authority.[110]

But the position in this regard does not appear to be as simple as this statement of Street makes us to believe. The courts have never followed a consistent policy in deciding what are misrepresentations of a matter of law and what are misrepresentations of a matter of fact. If the courts had been consistent in their approach, it would be extremely difficult to explain as to how, when the misrepresentation involved in Colonial Bank's[111] and Kitson's[112] cases were held by the courts to be matters of fact, could the misrepresentation involved in Rashdall v. Ford[113] be held to be a matter of law. Therefore the obtaining of relief by the aggrieved third party under this right is very uncertain.

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110. See Street, A Treatise on the Doctrine of Ultra Vires, Proposition 136, p. 318 (1st ed., 1930).

111. Cherry and M'Dougall v. The Colonial Bank of Australasia, (1869) L.R. 3 P.C. 24; see text to note 96, supra.

112. West London Commercial Bank Ltd. v. Kitson, (1884) L.R. 13 Q.B.D. 360 C.A.; see text to note 102, supra.

113. (1866) L.R. 2 Eq. 750; see text to note 106, et.seq., supra.

CONCLUSIONS AND SUGGESTIONS

We have seen in the last chapter how the doctrine of *ultra vires*, once very useful for the shareholders and creditors of the company, has now become devoid of any virtue. We have also seen that it still retains its potentiality for vice, namely, that it can allow persons to avoid with impunity an obligation which ought to be fulfilled in good conscience and can thus be a trap for the other innocent party. In this chapter we have seen that the entrapped third party is not completely without a remedy as he has three types of remedy, the availability of one or the other depending on the circumstances of each case. The three remedies, we have seen, are (1) the right to trace his property into the assets of the company, (2) the right to retain the security once obtained, and (3) the right to proceed against the directors personally.

But it is clear from what has been written above about these remedies that these remedies are of limited efficacy only. The right to trace, despite all its equitable extensions, is incapable of being available to the third party in case of services which the third party might have rendered to the company and for which he ought to be remunerated. The right to retain the security once obtained is obviously of very limited efficacy as it depends for its availability on the obtainment of a security and, further, the security,

even if obtained, cannot be enforced by the third party.[114] About the right of the aggrieved third party to proceed against the directors personally, it has already been written above that the actual availability of a relief under this right is very uncertain. Besides, it is also clear that rules in regard to these remedies have made this branch of the law very much complicated.[115]

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114. See text to note 89, supra.

115. Pennington in order to illustrate the complicated nature of rules comprising this branch of the law in England gives an example which is given ~~xx~~ below:

> A company has power to borrow upto £ 5,00,000. It has already borrowed £ 4,90,000, and it borrows a further £ 1,00,000 from A, telling him that the loan is required to pay for machinery. The company pays A's cheque into its bank account which immediately previously had a credit balance of £ 30,000, and then the company draws the following sums out of its account:- £ 20,000 for the purchase of machinery; £ 50,000 in payment of debts; £ 10,000 for repairs to the company's factory; and £ 90,000 for the purchase of shares in another company. After A's cheque is paid in, the company pays in further cheques amounting to £ 80,000 to the credit of its account.
>
> A's rights are as follows:-
>
> (1) To be paid £ 10,000, the portion of his loan which the company had power to borrow.
>
> (2) To have the machinery sold and the proceeds paid to him. The company has by its own act appropriated £ 20,000 out of A's loan to this purpose.
>
> (3) To be subrogated to the creditors whose debts were paid off, but only to the extent of £ 20,000 because it was only to this extent that the company drew against A's cheque to pay the debts (rule in Clayton's Case).

All these factors underline the need for a major legislative operation on the body of the doctrine of ultra vires, aiming at simplification of the law and yet ensuring justice to the third party.

It is therefore suggested that the doctrine of ultra vires with regard to registered companies should be abolished and registered companies, in their dealings with outsiders, should have the same legal capacity to act as a natural person, and so, as between the outsiders and the company, the company should take full responsibility for its acts.[116] The memorandum of association should law down the power of the company and, as bwtween the company and its managerial personnel, if the latter take the company beyond

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115. contd.....

4) To trace the balance of his loan into the shares bought by the company. The balance will be £ 1,00,000, less the amounts he has already received (£ 50,000) and the amount drawn against his cheque (under Clayton's Case) for the repairs (£ 10,000), leaving £ 40,000. At the date of the purchase the company's own money in its bank account is £ 80,000, so that A will be entitled to $\frac{40,000}{1,20,000}$ or one-third of the proceeds of sale of the shares, which should yield him a further £ 30,000.

In total, therefore, A should recover £ 80,000. See Pennington, The Principles of Company Law, pp. 75, note (h) (1st ed. 1959).

116. See the comments added at the end of the discussion of In re Madras Native Permanent Fund Ltd., in the last chapter.

those powers, they should be obliged to refund to the company, as they do even now in the case of ultra vires expenditure,[117] the entire money the company had to spend on fulfilling its responsibilities arising out of activities beyond those powers. If this suggestion is accepted, section 10 of the (Indian) Limitation Act, 1963 will also have to be amended so as to make it expressly applicable to the managerial personnel of a company.[118]

The x Company Law Committee in India, popularly known as the Bhabha Committee, looked at the matter from the point of view of managements of companies continuing to "indulge in activities only very remotely connected with their principal business", and remarked: "For the present, we do not think that the evil is either so serious or widespread as to call for immediate action".[119] Strangely enough, it did not look at the matter from the point of view of innocent persons who are put to hardship for no fault of theirs, but as a result of the doctrine of ultra vires. It is submitted that even if such hard cases may not arise very frequently, the rule is so obviously unfair that its immediate replacement by the rule suggested above is very desirable. The adoption

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117. See supra under the heading, "Rights of the Company and Shareholders under Ultra Vires Transactions".

118. See the discussion of Kathiawar Trading Co. v. Virchand Dipchand in the last chapter and also supra.

119. See Report of the Company Law Committee, 1952, para 33, p. 30.

of the suggested rule, it is submitted, would not violate any legal principle, but it would, besides being in consonance with justice, relieve this branch of the law of the complications and complexities which at present disfigure it.[120]

It is hoped that these suggestions, if accepted, will go a long way towards relieving the hardships of the unwary third party and towards simplification of this very complex branch of law. The question now remains as to what should be done for protecting the shareholders in regard to the squandering of the company's money by the managerial personnel on projects which, though falling within the unlimited scope of the present day objects clauses, nevertheless, are far removed from the main purpose or purposes of the company for the pursuance of which, really speaking, the shareholders invested their money in the company.

The Bhabha Committee, though they thought it desirable to put some curbs on the companies' taking powers in their memoranda of association to undertake every conceivable activity, nevertheless, "found it difficult to devise a working formula under which restrictions could be imposed on their powers to do so, without introducing an element of rigidity into their constitution that might, on occasions, seriously prejudice their interest or impede their

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120. This entire Part and particularly the present chapter bear evidence to these complications and complexities.

efficient working and the growth of industries".[121] The Committee, however, preferred to rely on the expected growth of responsible judgment among the managerial personnel and the likely creation of a greater degree of alertness on the part of shareholders. As written above, the Committee thought that, at that time, despite wide powers in the memoranda of association, the evil of the companies' indulging in activities very remotely connected with their principal business was not so serious or widespread as to call for immediate action.

But this assessment of the situation by the aforesaid expectations of the Bhabha Committee could not hold ground for long in the face of revelations made by the Vivian Bose Enquiry Commission in its Report submitted to the Union Government on 18th June, 1962.

This Report brought to light the following facts.[122]

A public company, Dalmia Jain Airways Ltd., which was before the Commission, was incorporated primarily for the purpose of carrying on an Airline business, although it

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121. See Report of the Company Law Committee, 1952, para 33, p. 28.

122. See Report of the Commission of Inquiry (Investigations & Recommendations), at p. 1, published by the Deptt. of Company Law Administration, Ministry of Commerce and Industry, Government of India.

transpired that there was never any serious intention to do such business. The reason for floating this company in that form was that, at the time of its incorporation, Airline business was very much popular with the public and there was a big demand for shares in such companies. It is significant that though the ostensible main business was given prominence in the memorandum, the activities which the company actually intended to pursue, namely, business in all types of surplus motor vehicles and spare parts left by the American fighting forces in India at the conclusion of the second world war, were mentioned in an omnibus clause that spoke of "vehicles of all kinds" along with humbler kinds of conveyances like "cycles, carriages and perambulators". No one could have imagined by a simple statement in the memorandum that the main business was that of dealing in motor vehicles and spare parts involving an outlay of almost Rs. 6 crores, and the principal business was merely to be a small side show with an investment of about Rs. 22 lakhs only. The public was misled by the name of the company, which was rightly supposed by them to incorporate its main object. The memorandum having comprehended within its scope the dealing in motor vehicles and spare parts, the persons in control, without reference to the shareholders, were able to divert the funds so obtained into the surplus motor vehicles and spare parts business.

In view of disclosures such as these, the Commission was asked to report separately as to what action, in its

opinion, should be taken to act as a preventive in future cases and the measures which, it thought, were necessary in order to ensure in the future the due and proper administration of the funds and assets of companies in the interest of investing public.[123]

The Commission in its Report submitted on 31st October, 1962, admitted that in recent times there had been instances where companies had gone in for diversification and had diversified their activities into lines other than the principal object or objects ancillary thereto. The Commission, however, did not like to condemn diversification as such, and felt that this tendency might largely be due to the system of inter-corporate taxation of dividends. In the Commission's opinion, in countries where inter-corporate taxation did not exist, the tendency for a group was to form separate subsidiary companies under the main holding company; but this would prove to be far too expensive from the tax point of view in this country owing to dividends being taxed at each stage of its corporate travel.

Nevertheless, the Commission thought that the shareholders should have some say in the matter and to this end they made the following recommendations:

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123. See items (10) and (11) of the Terms of Reference of the Vivian Bose Commission, quoted in the Report of the Commission of Inquiry (Investigations & Recommendations), at p. 1.

(i) The Act should be suitably amended to provide that every company shall clearly state its purposes and objects under two separate categories, viz.,

(a) the principal and ancillary objects which the company intends at the time of its incorporation to pursue; and

(b) all other objects which are separate from the principal and ancillary ones mentioned in item(a) above.

(ii) A provision should be made in the Act to the effect that a company shall not engage itself in any activities coming within the scope of clause (b) unless such activities are sanctioned by a special resolution of the company in general meeting. (124)

The Government of India referred the recommendations of the Bose Commission to a committee consisting of Mr. C.K. Daphtary, the Attorney General of India, and Mr. A.V. Sastri, a senior Advocate of the Supreme Court, for scrutiny and recommendations. This committee in its recommendations, submitted on 25th April, 1963, expressed dissatisfaction at the above-given recommendations of the Bose Commission and thought that the remedy did not lie merely in making provision foe separating the principal objects from other objects because even then it was possible to include under the head "principal objects" a variety of objects not necessarily having any connection with one another, nor reflecting the real intention of the promoters.

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124. See Report of the Commission of Inquiry (Investigations and Recommendations), at p. 2.

This committee was of the view that further statutory provision should be made whereby, even at the initial stage, the shareholders are given an opportunity to inform themselves of the principal industrial or business activity the company would embark upon.

The committee made the following recommendations:[125]

(1) That the promoters, the signatories to the memorandum and the first directors of a company should be required to obtain the approval of the company in general meeting by a special resolution, of the decision of the directors regarding the activities the company shall engage in, in the first instance;

(2) Thereafter sanction of the company in general meeting by special resolution should also be obtained, if the directors later on propose to engage in new activities;

(3) Every such resolution should be incorporated in all copies of the memorandum of the company;

(4) Provision should be made in the Capital Issues (Control) Act for informing the Controller of the starting of a fresh business enterprise in accordance with the aforesaid special resolutions; and

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125. See the Daphtary - Sastri Report (cyclostyled), entitled, Amendment and Administration of the Companies Act, under the heading, "Memorandum of Association", at pp. 3-4. This Report in this very form was placed on the table of the Lok Sabha.

(5) A copy of the special resolutions enlarging the business of the company should be furnished to the Registrar of Companies of the State.

As the name of the company also influences the public who apply for allotment of shares, the committee thought, that the Registrar of Companies should be empowered to scrutinise carefully the objects specified in the memorandum to see whether the name of the company properly reflected those objects and was not likely to mislead the public. The committee expressed the view that registration of a company should be withheld until the Registrar was satisfied on this score.

The committee was also of the view that provision should be made in the Companies Act imposing an obligation on the promoters of a public company to include in newspaper advertisements announcing the floatation of a company, a statement calling attention of the public to the specific objects to which the activities of the company would be confined in the first instance, and to publish equally prominent advertisements as and when the company proposed to embark upon any other business enterprise.[126]

The Indian Parliament, while enacting the Companies (Amendment) Act (No. 31 of 1965), did not accept these recommendations of the Daphtary-Sastri committee and though

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126. See Ibid., at p. 4.

the Parliament appeared to adopt the recommendations of the Vivian Bose Commission, it adopted them only halfheartedly. While section 5 of the Amending Act adopted the Bose Commission's suggestion in regard to classifying the objects into "principal objects" and "other objects",[127] it failed to adopt the allied suggestion of the necessity of passing a special resolution before the company could pursue an object given in the category of "other objects". This omission, it is submitted, robs the Bose Commission's recommendations of whatever merit they possessed and therefore section 13 of the Companies Act, 1956, even after its amendment by the Companies (Amendment) Act, 1965 does not, practically speaking, make any improvement whatsoever over the position existing before the amendment. It is submitted that the remedy seems

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127. This suggestion also, the Amending Act adopted only in regard to companies coming into existence after the passing of this Act and not in regard to all companies. In this connection, Report of the Joint Committee stated: "It was represented to the Committee that if the existing companies were also to be required to redraft their object clauses, then that would require the passing of special resolution under the Act, which would involve tremendous time and effort not commensurate with the results intended. The Committee, therefore, feel that this clause should be amended to provide that the provisions of existing clause (c) of Section 13 of the Act should continue to apply to companies in existence immediately before the commencement of the Companies (Amendment) Act, 1965 and the provisions of the proposed new clause requiring the division of objects into (i) main objects and objects ancillary thereto and (ii) other objects should apply only to new companies. The clause has been amended accordingly". — See item 13 of the Report of the Joint Committee on the Companies (Second Amendment) Bill, 1964, which was signed by its Chairman on 17th February, 1965, was presented to the Lok Sabha on the 23rd February, 1965 and was published by the Lok Sabha Secretariat, New Delhi.

to lie in adopting the recommendations of the Daphtary-Sastri report, discussed above. It is surprising that the Parliament, while enacting the Amending Act of 1965, completely overlooked the well-thought-out suggestions of an expert committee of the stature of the Daphtary-Sastri[128] committee.

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128. Mr. C.K. Daphtary was and still is, as is well-known, the Attorney General of India. Mr. A.V. Sastri is a retired judge of the Madras High Court and a Senior Advocate of the Supreme Court. He headed the Companies Act Amendment Committee which submitted its report in 1957 and on the basis of which the Companies Amending Act of 1960 was enacted.

PART II

EXCESS OF AUTHORITY BY MANAGERIAL PERSONNEL OF A COMPANY

The authority of the managerial personnel of a company is generally defined by its Articles of Association and this is called their actual authority. Actual authority includes both express as well as implied authority. Implied authority means authority which is tied with express authority as being incidental to, or necessary for, the exercise of the latter. When the managerial personnel act within their actual authority, they undoubtedly bind the company by their acts. But they also bind the company by acts which, though in excess of their actual authority, come under any one of the following three categories: (1) The act falls within the purview of the famous rule in Royal British Bank v. Turquand[1], (2) the act has been duly ratified, or (3) the act is the borrowing of money which has gone to the coffers of the company and has been utilised for its purposes. In all the three cases it is essential that the act should not be *ultra vires* the company. Chapters 1, 2 and 3 of this Part deal with the first, the second and the third of these categories respectively.

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1. 5 El. & Bl. 248; 6 El. & Bl. 327.

The facts of the case Royal British Bank v.

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2. contd......

from averring that the person whom he has held out and pretended to be his agent is not in fact so". — Smith & Watts' Mercantile Law (8th ed. 1924), p. 177, note(s), quoted by Mr. J.L. Montrose in "The Apparent Authority of An Agent of A Company", 50 L.Q.R. 224, at p. 226, note 17 (1934).

Speaking about apparent authority, another learned treatise says: "Apparent authority is sometimes said to be the authority which the agent appears to a third party to possess. But if it is co-extensive with the agent's actual authority, express or implied, there is no point in talking about apparent authority. It is better, therefore, to apply the term 'apparent' only where the agent in fact has no authority, but appears to the third party to have authority as a result of representation by the principal to that third party". — See Dr. R. Powell, The Law of Agency, at p. 36 (2nd ed. 1961).

The same learned treatise, speaking about usual authority, says that usual authority means the authority which a person normally possesses in certain circumstances to act on behalf of another person, whether or not he is actually authorised so to act. "If the actual authority, express or implied, covers the usual authority, there is no point in referring to it as usual. But the actual authority, even when it is implied, i.e. extended by necessary implication, may still not cover the whole range of the usual authority. The reason is that implied authority is tied down to what is incidental to and necessary for the exercise of the express authority. It is therefore limited to the range of the express authority, i.e., to those matters which the principal himself has authorised. Usual authority, on the other hand, may go outside that range. It may cover acts which are not incidental to or necessary for the exercise of the express authority. For example, suppose that the usual authority of the manager of an inn includes the purchase of cigars for sale to the public. P may appoint A a manager of an inn and may forbid him to buy cigars. A therefore has no express authority to buy cigars; and we may assume that authority cannot be implied from any other terms of his express authority. But he is still the manager of an inn, and the manager of an inn has the usual authority to buy cigars". Dr. R. Powell, op.cit., at p. 37.

The facts of the case Royal British Bank v.

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2. contd......

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Turquand,[3] were as follows. The directors of a Company[4] of which the defendant was the official manager, borrowed from the plaintiff on bond under the seal of the Company. A clause in the registered deed of settlement provided that the directors might borrow on bond such sums as should, from time to time, by general resolution of the Company, be authorised to be borrowed. It was contended on behalf of the Company that there had been no such resolution authorising the making of the bond. But it was not shown that the plaintiff knew of the absence of the resolution.

Lord Campbell, C.J., delivering the judgment of the Court of Queen's Bench, observed:

> "If no illegality is shown as against the party with whom the directors contract under the seal of the Company, excess of authority is a matter only between the directors and the shareholders . . . at all events, we think that the bond cannot be rendered illegal and void from any irregularity in the proceedings of the Company, nor even by an excess of authority, the plaintiffs having acted with good faith, and the

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3. 5 El. & Bl. 248; 6 El. & Bl. 327.

4. The name of this company was Cameron's Coalbrook, Steam, Coal and Swansea and London Railway Company.

shareholders not being prejudiced. The plaintiffs have bona fide advanced their money for the use of the Company, giving credit to the representations of the directors that they had authority to execute the bond; and the money which they advanced and which they now seek to recover, must be taken to have been applied in the business of the Company and for the benefit of the shareholders. If the plaintiffs must be presumed to have had notice of the contents of the registered deed of settlement, there is nothing there to shew that the directors might not have had authority to execute the bond as they asserted". (5)

With these words the Court gave judgment for the plaintiff.

This judgment of the Court of Queen's Bench was affirmed by the Court of Exchequer Chamber. Jervis, C.J. with whom the other judges concurred, in a very short judgment, observed:

"We may now take for granted that the dealings with these companies are not like dealings with other partnerships, and that the parties dealing with them are bound to read the statute and the deed of settlement. But they are not bound to do more. And the party here, on reading the deed of settlement, would find, not a prohibition from borrowing, but a permission to do so on certain conditions. Finding that the authority might be made complete by a resolution, he would have a right to infer the fact of a resolution authorising that which on the face of the document appeared to be legitimately done". (6)

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5. 5 El. & Bl. 248 at pp. 261-262.
6. The Royal British Bank v. Turquand, 6 El. & Bl. 327 at p. 332.

The rule laid down in this case was elaborated and applied by the House of Lords in Mahony v. East Holyford Mining Co.[7], where Lord Hatherley gave it the name of doctrine of "indoor management" and stated it in the following words:

> "After than, the Company entering upon its business and dealing with persons external to it, is supposed on its part to have all those powers and authorities which, by its articles of association and by its deed, it appears to possess; and all that the directors do with reference to what I may call the indoor management of their own concern, is a thing known to them and known to them only; subject to this observation, that no person dealing with them has a right to suppose that anything has been or can be done that is not permitted by the articles of association or by the deed . . . . But, after that, when there are persons conducting the affairs of the Company in a manner which appears to be perfectly consonant with the articles of association, then those so dealing with them, externally, are not to be affected by any irregularities which may take place in the internal management of the Company". (8)

Having thus described the rule[9] in Royal British Bank v. Turquand, it is now proposed to examine the cases in

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7. (1875) L.R. 7 H.L. 869.

8. Ibid., at pp. 893-894.

9. In describing the rule, we concerned ourselves only with the basic rule which was laid down in the two fundamental cases, namely, Turquand's and Mahony's. We purposely omitted taking note of the "subsequent history of the rule", which according to Professor Gower, The Principles of Modern Company Law, (2nd ed. 1957), has been such extensive limitations on the rule that "the basic object of the rule sometimes seems to have been lost sight of" (p.143). Professor Gower, op.cit., has tendered a piece of advice in

which Indian Courts, following this rule, have held acts of the managerial personnel in excess of their authority binding on their companies.

In Raja Bahadur Shivlal Motilal v. The Tricumdas Mills Co. Ltd.,[10] the facts were as follows.[11] By a mortgage of the 15th April, 1906, the defendant Company mortgaged to the plaintiff certain property to secure a loan of Rs. six lacs. At the beginning of August, 1909, the defendant Company applied to the plaintiff through their agents[12] for a further advance of Rs. five lacs, of which

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9. contd.........
this regard in the following words: "If this branch of the law is ever codified the draftsman will be well advised to ignore all case-law of the present century and to go back to first principles and the judgments of the founding fathers of our modern company law" — (pp. 143-144). As will be seen in the discussion of Indian cases which follows, the Indian Courts seem to have adopted the same course and have followed the rule in Turquand's case only in its original form.

10. (1911) I.L.R. 36 Bom. 564, decided under Original Civil Jurisdiction by Davar, J. of the Bombay High Court on August 22, 1911. The plaintiff was a creditor of the defendant company which was a joint-stock company incorporated under the Indian Companies Act, 1882.

11. This is a very lengthy judgment and the facts are complicated. Here only strictly relevant facts in a simplified manner are given.

12. That is, managing agents, more or less, a peculiarly Indian institution.
s. 2 (25) of the (Indian) Companies Act, 1956.

Rs, two lacs were required urgently, on the security of a further charge of the defendant's property to be given to the plaintiff. The plaintiff advanced Rs. two lacs to

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12. contd..........

defines the expression "managing agent" as meaning "any individual, firm or body corporate entitled, subject to the provisions of this Act, to the management of the whole, or substantially the whole, of the affairs of a company by virtue of an agreement with the Company or by virtue of its memorandum or articles of association and includes any individual, firm or body corporate occupying the position of a managing agent, by whatever name called".

Section 368 of the same Act lays down:

"The managing agent of a company, whether appointed before or after the commencement of this Act, shall exercise his powers subject to the superintendence, control and direction of its Board of directors and subject also to the provisions of the memorandum and articles of the company and to the restrictions contained in Schedule VII".

Thus managing agents are persons entrusted with the management of the whole, or substantially the whole, of the affairs of a company and are required to exercise their powers subject to the superintendence, control and direction of its Board of directors. Theoretically, they have always been understood to be working under the superintendence, control and direction of the Board of directors; though practically it was not so in the past because most of the members of the Board of directors used to be the managing agent's nominees, either directly (i.e. through direct nomination) or indirectly (i.e. through election because managing agents often possessed great deal of voting power), and so were servile to them. This gap between theory and practice is considerably narrower now; because, firstly, under s. 377 of the (Indian) Companies Act, 1956, the maximum number of directors capable of being directly nominated by managing agents cannot exceed two if the total number of directors exceeds five and one director if the total number does not exceed five; and, secondly, though,

the defendant company on the 5th of August, 1909, and was given by the defendants in receipt therefor a document which acknowledged receipt of Rs. two lacs and which, inter alia, stated that the said two lacs formed part of a sum of five lacs intended to be advanced by the plaintiff. It further stated that in case he decided to make such advance, the company shall execute a proper legal deed of further charge to secure the said amount of Rs. five lacs. Thereafter, the plaintiff decided to make the proposed advance and signified his intention to the defendants. A formal deed of charge was prepared but not executed owing to the insolvency of the defendants and other circumstances.

The plaintiff got the receipt passed in his favour by the defendants stamped as a charge on land and

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12. contd........

normally directors, are appointed by ordinary resolution but persons connected with managing agents require special resolution, under s. 261 of the Companies Act, 1956, for appointment as directors; thus making it more difficult for managing agents to get their nominees appointed to the Board.

Prior to Companies (Amendment) Act, 1960 (No.65 of 1960), there was no restriction on simultaneous employment by a company of more than one categories of managerial personnel and so companies could and used to have at the same time managing agents as well as managing directors. But the aforesaid Amendment Act has added s. 197A to the Companies Act, 1956, because of which a company can now have at one time only one i.e., managing agents or managing directors.

registered. On the 17th of September, 1909, the defendant company was adjudicated insolvent and a liquidator was appointed thereof. Under orders of the Court, the liquidator sold the mortgaged property and paid the mortgage debt to the plaintiff.

The plaintiff thereon sued the defendants for a declaration that he was entitled to a charge on the balance of the said sale proceeds for the sum of Rs.2,09,435-9-9 being the said advance of Rs. two lacs and interest and for payment of the said sum. In their written statement, the defendants submitted that the receipt of the 5th of August, 1909, did not effect a charge on the defendants' property. The defendants denied that any resolution had been passed by the defendants' Board authorising the creation of a charge or that a duly constituted Board existed at the date of the receipt. The main question in this suit was whether the plaintiff was entitled to a charge on the defendants' property, and to rank as a secured creditor, or merely to share rateably as an ordinary creditor.

His Lordship found as facts that on the 5th of August, 1909, when Exhibit B[13] was executed, the Board of Directors of the defendant company was defective, in that there were only three directors instead of the

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13. That is, the document acknowledging receipt of Rs. two lacs, mentioned in the text.

minimum four, as required by the Articles of Association and that prior to the execution of this document no resolution had been passed by the defendant Company's Board of Directors authorising the creation of a charge. These undoubtedly, according to his Lordship, were irregularities. But the question was, did these irregularities invalidate a charge in favour of third parties without notice of such irregularities and entitle the defendant Company to plead the irregularities of their own Board of Directors as a bar to the successful establishment of a claim against themselves? His Lordship observed: "A close study of the authorities establishes beyond all doubt that in law neither the want of a resolution nor the defect in the Board of Directorate can affect adversely the rights of third parties who have no knowledge of the existence of such infirmities. The authorities on the subject are both clear and conclusive".[14]

Thereafter his Lordship discussed several English cases including Royal British Bank v. Turquand[15] and Mahony v. East Holyford Mining Company[16] and came to the conclusion that on those authorities it was impossible to hold that in this case if the plaintiff Raja Bahadur Shivlal

14. (1911) I.L.R. 36 Bom. 564 at p. 586.
15. See supra.
16. See supra.

Motilal acquired a charge[17] on the property of the defendant-Company, that that charge was invalid and not binding on the Company because, at the time the charge was given, the Board of Directors had not passed a resolution authorising the creation of such charge and by reason of there being not at that time in existence a Board of Directors properly constituted, according to the requirements of the Articles of Association.

His Lordship held:

> "The plaintiff and his legal advisers assumed, as they had a perfect right to assume that what was being done was righly and legitimately done and that all the requirements for the execution of the document, which was executed by the Managing Director and another Director of the defendant-Company and a countersigned by the firm of its Secretaries, Treasurers and Agents (18)

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17. And in this regard his Lordship held that having regard to the circumstances under which the sum of Rs. two lacs was advanced by the plaintiff, having regard to the language of the document executed on that occasion and to the contents thereof and the terms and conditions mentioned therein, having regard also to the action of the parties subsequent to the execution of that agreement and the events that followed, his Lordship had no hesitation in holding that a valid, legal and binding further charge was created in favour of the plaintiff against the mortgaged property of the defendant-Company for the two lacs of rupees advanced by the plaintiff on the 5th of August, 1909. See (1911) I.L.R. 36 Bom. 564, at p. 598.

18. See Note 12 Supra.

> and bore the Company's seal, had been duly complied with, previous to the execution of that document. The plaintiff and his solicitors had no knowledge whatever that the Board of the defendant-Company's Directors was defective for want of the minimum number of directors required by the Articles of Association. The plaintiff's solicitors had a perfect right to assume that the requisite resolution was previously passed and that everything that was done was done regularly and properly". (19)

This act of borrowing and giving charge on the assets of the Company by the managerial personnel in the absence of a proper enabling resolution of a properly constituted Board of Director, was clearly in excess of the authority of the managerial personnel. But the Court held this act binding on the Company as the circumstances of this case fell within the purview of the rule in Royal British Bank v. Turquand.

In Charnock Collieries Co. Ltd. v. Bholanath Dhar,[20] the facts were as follows.[21] The Company's articles of

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19. (1911) I.L.R. 36 Bom. 564, at p. 593.

20. (1912) I.L.R. 39 Cal. 810, decided in original civil jurisdiction of the High Court of Calcutta by Fletcher, J. This was a Special Case stated for the opinion of the Court under order XXXVI of the Code of Civil Procedure, 1908, by agreement between the Charnock Collieries, Ltd., in liquidation, and the liquidators-plaintiffs, on the one hand, and Bholanath Dhar, defendant, on the other hand.

21. Only strictly relevant facts in a simplified form are given.

association empowered the managing agents, with the approval of the directors, to borrow or raise sums of money for the purposes of the Company, and to secure repayment of such sums by mortgage of, or charge on, the property of the Company and to draw all such instruments as should be necessary for the carrying on of the business of the Company, and directed that every document to which the seal of the Company was affixed should be signed by at least one director, and countersigned by the managing agents. Bholanath Dhar, a stranger, advanced money to the managing agents who were acting on behalf of the Company, which was credited in the Company's books under loan account and was given an instrument[22] by way of hypothecation or security, to which was affixed the seal of the Company and which was signed by the managing agents; but it did not sufficiently appear that the money had been borrowed with the approval of the directors, and the instrument was not signed by any of the directors as required by the articles.

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22. Which was an Indenture made on the 3rd January, 1910, between the Company and Bholanath Dhar, stating that the Company thereby deposited with Bholanath Dhar the title-deeds of its colliery and assigned all the plant, machinery, etc., in or about the said colliery, by way of hypothecation or security, for the repayment of the loan and stating that the company thereby put Bholanath Dhar in possession of the colliery. The title-deeds of the colliery were deposited with Bholanath Dhar.

The Company subsequently went into liquidation and its colliery[23] was, by agreement between the parties, sold and the proceeds of the sale were in the hands of the attorney to the liquidators. Bholanath Dhar claimed to be a secured creditor of the Company by virtue of the Indenture[24] of the 3rd January, 1910, for principal and interest due under the said Indenture. His claim was resisted on the ground that the Indenture was invalid and of no effect in creating a security, inasmuch as the money had been borrowed without the approval[25] of the directors, and the Indenture was not signed[26] by any of the directors of the company.

In the opinion of Fletcher, J., the point really was whether the Indenture not having complied with the terms of the articles of association of the company, had the

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23. That is the subject-matter of hypothecation.

24. See note 22.

25. Article 49 authorised the managing agents with the approval of the directors to borrow money. It was argued on behalf of the Company that the matter was not one of mere internal management. It was one of the essential conditions necessary to give the managing agents power. The lender must show that the approval of the directors had been given.

26. Article 112 directed that every instrument to which the seal was affixed should be signed by at least one director and countersigned by the managing agents.

defendant a valid charge on the property of the company? His Lordship thought that he had, as this case was covered by authority starting, in his Lordship opinion, with the case of the Royal British Bank v. Turquand.

His Lordship held:

> "The point is this, whether a person dealing with the company is bound to look into . . . the 'indoor management' of the company, that is whether a person dealing with the company is bound to see whether the act of the company is not *ultra vires*, or whether he may assume that all the acts done by the company or on its behalf are regular and proper. In my opinion in this case the lender was entitled to assume that the managing agent had the authority of approval of the board of directors . . . . The lender when he advanced money to the company was entitled to assume that the managing agent had obtained the approval of the board of directors to the borrowing of these sums". (27)

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27. (1912) I.L.R. 39 Cal. 810, at pp. 818-819.

With regard to the second objection of the Company, that the Indenture was not signed by a director as required by Article 112, his Lordship held that under Article 50 the managing agents had ample power to give a security. That being so, the affixing of the seal on the document, in his Lordship's opinion, was not necessary and only the signature of managing agent was ample. But in order to further strengthen his decision, his Lordship observed at p. 820: "If that was not so, I should have decided upon the well-known class of cases where a person who advanced money to a company upon the terms that security should be given to him, even if the security be not complete, he is nevertheless entitled under the rules of equity to have a charge on the property of the company. That class of cases rests on the elementary maxim of equity, that equity looks upon that as done which is agreed to be done. If the money were borrowed on account of the company, it is not open to the company to say that the person who lent the money is not entitled to a charge".

In Ram Baran Singh v. Mufassil Bank Ltd.[28] a power of attorney was executed by Kayastha Banking and Trading Corporation Ltd. in favour of its Manager, B. Ram Gharib Lal,[29] authorising him to sign and endorse on behalf of the company, deeds, bonds and conveyances, and to transfer decrees, negotiable instruments and other documents, the transfer, assignment or endorsement whereof was sanctioned in writing by the Board of Directors or by any of the directors authorised in that behalf by the said Board. The Manager assigned[30] certain decrees to an outsider though there was nothing to show that any sanction had been granted for the sale of these decrees by the Board of Directors or by any director authorised in that behalf by the said Board. The sales, however, purported to have been effected on behalf of the Corporation.

In the opinion of Kanhaiya Lal, J., the real question was whether a third party, who dealt with the Manager in the above circumstances, was bound to go behind

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28. (1925) A.I.R. All. 206 (2), decided as Second Appeal by Kanhaiya Lal, J., of the Allahabad High Court.

29. B. Ram Gharib Lal was the manager. He was appointed manager by the Articles of Association and by a subsequent resolution of the Board of Directors, dated the 4th April, 1917, he was also appointed one of its directors.

30. The consideration paid by the assignee was credited in the accounts of the Corporation.

his apparent authority to enquire whether the Manager had obtained the sanction of the Board of Directors to effect the sales. His Lordship thought that not only did the acts of Directors bind the company when done within the scope of their authority, but also where the acts of Directors, however irregular, belonged to a class of acts which was authorised by the constitution of the company and that a company was bound by its dealings with strangers who acted _bona fide_ with the company. Further, according to his Lordship, the Articles of Association of a company defined the power of Directors as between themselves and the company, and unless there was anything in those Articles limiting the powers of the Board of Directors in carrying on the ordinary business of the Corporation, a third party who dealt with the Directors or with the Managers acting under those powers, however irregularly, was protected if he acted in good faith in his dealing with them.

For these reasons, his Lordship held:

> "The sales in the present case were irregular, because they do not appear to have been made with the sanction of the Directors, as required by the power of attorney which conferred the power of sale. But if any damage has accrued to the company by reason of the Manager having acted beyond his authority in the ordinary discharge of his duties, the remedy of the company is against such Manager, and the sales cannot be set aside to the prejudice of a third party, who

has already paid in good faith the considera-
tion thereof, which the company has appropria-
ted". (31)

In Prabodh Chandra Mitra v. Road Oils (India) Ltd. and others,[32] the plaintiff-appellant's allegation was that the defendant-respondent company, being a company which manufactured and sold certain road-oils, appointed him on April 18, 1928, as its financial agent with the duty to find moneys upto a certain limit necessary for carrying on the business of the company and with the sole right to collect all sums due to the company in respect of the oils supplied. He claimed to have a charge on all sums due to the company in respect of the advances that he had made to the company. The defendant-respondent company admitted that the agreement of 18th April, 1928, had been entered into.

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31. A.I.R. 1925 All. 206 (2) at p. 208, Col. 2. In holding this, his Lordship relied on Biggerstaff v. Rowatt's Wharf, Ltd., (1896) 2 Ch. 93, and Grant's Law of Bankings, 6th Edition p. 607. Biggerstaff v. Rowatt's Wharf, Ltd., is a case belonging to the family of cases headed by Royal British Bank v. Turquand.

    Apart from and in addition to these grounds for decision, his Lordship also held that there was ratification of the sales by the Corporation and its directors.

32. A.I.R. 1930 Cal. 782, decided as an appeal by a Bench consisting of Rankin, C.J., and Buckland, J., of the Calcutta High Court. This appeal was against a decree of Page, J., by which the learned Judge declared that the agreement dated 18th April, 1928, purporting to create a charge on the outstanding bills due to the defendant company for the amount due to the plaintiff was not binding on the defendant company.

They referred to its terms for a proper construction and denied that it conferred a charge but they claimed that they had acted faithfully in terms of the agreement.

The document executed on the 18th April, 1928, was signed by Thomas, one of the three directors, and it did not appear that the directors had delegated their authority to him, though under the Articles of Association it was possible for them to delegate their authority to him. Further, the Articles required that the seal of the company had to be put on a document in the presence of two directors, while this document was under the seal of the company and yet signed by only one director.

Now, in these circumstances, the reasoning[33] of the trial-court Judge, Page, J., was that although there was no meeting of the directors to confer any authority upon Thomas, to create a charge on behalf of the company by an instrument executed by himself or a bargain made by himself on behalf of the company; nevertheless under the articles it was quite possible for such powers to have been delegated to Thomas. As it was not suggested that the plaintiff knew of any fact to the contrary, the learned

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33. This reasoning of the trial-court was stated by Rankin, C.J., in his judgment. See A.I.R. 1930 Cal. 782, at p. 786, columns 1 and 2.

Judge therefore began by holding that the plaintiff was not concerned to enquire whether Thomas was properly delegated by the Directors because on the principle of the case of Biggerstaff v. Rowatt's Wharf Ltd.,[34] that was a matter of internal management as to which a stranger was entitled to act on the presumption that the director had such authority as it was possible for him to have under the regulations. Consequently, the learned Judge agreed that, so far as the plaintiff was concerned, if he made a bargain with Thomas on behalf of the company, it would prima facie be a bargain which would bind the company.

Rankin, C.J., in a judgment in which Buckland, J., concurred, expressed perfect agreement with this view of the trial court and held that the plaintiff-appellant was entitled to presume under the doctrine of "indoor management" that the director with whom he dealt, had the authority to act on behalf of the company which it was possible for him to have under the Articles of Association; and so his Lordship declared that the agreement of 18th April, 1928, was binding on the

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34. (1896) 2 Ch. 93. This case, as written in note 31, supra, belongs to the family of cases headed by Royal British Bank v. Turquand.

defendant-respondent company and that it created a valid charge in favour of the plaintiff-appellant.[35]

In Dehradun Mussorie Electric Tramway Co., Ltd. v. Jagmandar Das,[36] the defendant-appellants were a limited Company (in liquidation) with its registered office at Dehradun, and the plaintiff-respondents were the proprietors of a bank at Dehradun; the company having an account with the bank. On 19th January, 1923, the plaintiffs allowed the Company, at the request of their managing agent, Mr. Beltie Shah Gilani, who was also a director ex-officio, an over-draft of Rs.25,000. Mr. Beltie Shah Gilani, on

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35. Rankin, C.J., disagreed with Page, J., where Page, J., held that the document of 18th April, 1928, was not binding on the company and therefore did not create a charge because under the Articles, the seal of the company was to be put in the presence of two directors while in the present case it was put in the presence of only one director. Rankin, C.J., held that as in this case an agreement under seal was not necessary, mere irregularity in the affixing of the seal would not affect the binding nature of the document and, further, the principle to be applied was that where the court was satisfied that it was intended to create a charge and that the parties who intended to create it had the power to do so, the court would give effect to the intention, notwithstanding any mistake which might have occurred in the attempt to effect it. Again, as the document in this case had been acted upon by the company, his Lordship thought that on principle of estoppel also, the document and the charge created by it should be binding on the company.

36. A.I.R. 1932 All., 141, decided in appeal by Banerje and King, JJ., of the Allahabad High Court.

19th June, 1923, executed a mortgage-deed on behalf of the Company in favour of the plaintiffs to secure the overdraft. The defendants admitted receipt of the consideration by the Company, and that the overdraft of Rs.25,000 was utilised for the necessary purposes of the Company. The defendants had no objection to treating the plaintiffs as unsecured creditors but pleaded that the Company was not bound by the mortgage-deed because Mr. Beltie Shah, the managing agent, had no power to execute the mortgage-deed on behalf of the Company.[37] The defendants in appeal pressed the same points that were taken in the trial court in support of their contention that the mortgage-deed was not valid and binding upon the Company.

The Board of Directors had power under the Articles of Association to borrow money for the purposes of the Company and to secure the loan by a mortgage. The Board of Directors had also the power, under Article 104, to delegate any of their powers other than powers to borrow and make calls, to committees consisting of such member or members of their body as they thought fit. It was argued on behalf of the appellants that as, under the last mentioned Article, the directors could not delegate their power to borrow, they could not also empower one of themselves, for example, Mr. Beltie Shah, to execute the

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37. The Trial Court had held that the mortgage was valid and binding on the Company and had decreed the plaintiff's suit. Therefore the defendant preferred this appeal.

mortgage. The reply to this was that the loan had already been incurred and there was no question of delegating the power of borrowing any further sums. The only question, in their Lordships' opinion,[38] for the directors was whether they should give the plaintiffs a security for the loan which the latter had already advanced.

Their Lordships, Banerje and King, JJ., held:

> "Under Article 104 we think the Board could legally empower one of the directors to execute the mortgage-deed on their behalf and to settle the details of the mortgage transaction. The result is that in our opinion the Board of Directors could legally authorise Mr. Beltie Shah to execute the mortgage on behalf of the Company by a resolution passed at a properly convened meeting. As a matter of fact, we hold that there was no properly convened meeting which passed the resolution (39) dated 22nd June, but the plaintiff had no reason to suppose that the resolution had not been properly passed. On these facts we consider that the plaintiff is

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38. See A.I.R. 1932 All., 141, at p. 145.

39. The minute-book of the Company set forth a resolution which purported to have been passed by a meeting of the directors of the Company held on 2nd June, 1923, in the following terms: "Resolved that the Board of Directors of the Dehradun Mussorie Electric Tramway Co. Ltd., approve of the proposal of the managing agents to the effect that in order to secure the over-draft of Rs.25,000 obtained by the Company from Messrs. Bhagwan Das & Co., bankers at Dehradun, the company's land known as . . . be legally assigned to the said Messrs. Bhagwan Das & Co., on such terms and conditions as may be settled between the managing agents and Messrs. Bhagwan Das & Co. The Board of Directors authorise Mr. Beltie Shah to enter into the agreement and give the necessary deed and deliver the deed on behalf of the Board". See (1931) 1 Comp. Cas. 227, at p. 233.

> protected in spite of the defect in passing the resolution, and the Company is bound by the mortgage so far as company law is concerned". (40)

In Sree Minakshi Mills, Ltd. v. Callianji & Sons,[41] the plaintiffs were Sree Minakshi Mills Ltd. and the defendant were (1) a firm of partners by the name of Callianjee & Sons, and (2) The Indian Bank, Ltd. The firm was at all material times acting in pursuance of an agreement, as managing agent of the plaintiff Company. The terms of the agreement were scheduled to the Articles of Association and Art. 132 provided, *inter alia*, that the firm "shall be and are hereby appointed the agents of the Company for the period and upon the terms, provisions and conditions set out in the (scheduled) agreement....... and the Board is hereby authorised to execute the said agreement on behalf of the Company".[42]

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40. In holdings this the learned Judges put reliance on Royal British Bank v. Turquand and Ram Baran Singh v. Mufassil Bank, Limited, both discussed above, and on a passage from the Halsbury's *Laws of England*, Vol. 5, (Edition not mentioned in the Report but most probably it was the First Edition), p. 302, which is in the following terms: "The persons contracting with a Company and dealing in good faith may assume that acts within the powers of the company have been properly and duly performed and are not bound to enquire whether acts of internal management have been regular".

41. (1935) 68 M.L.J. 510, decided as an appeal by Ramesam and Stone, JJ., of the Madras High Court. The judgment of the Court was delivered by Stone, J.

42. This Article has been reproduced here exactly in the form it appears in the judgment (at p.512). We do not have any other source of information by which to know as to whether there ought to be three dots or four dots in the dotted space within the quoted expression.

Article 100 appointed the first directors by name. Article 3 required the directors immediately after the registration of the Company to affix the seal of the Company to the scheduled agreement aforesaid with power to agree to modifications, though only in one event subject to the approval of the statutory meeting.

The Company was registered on 25th July, 1921, and on 29th March, 1923, received the certificate empowering it to commence business. The firm resigned all connections with the Company on or about 7th November, 1921. Between the date of registration of the Company and the date of resignation of the firm, the moneys of the Company were deposited with the Indian Bank, the 2nd defendant. The firm acting as managing agents operated on that account. There was no doubt that under the powers conferred on the firm by the scheduled agreement, the firm had power so to operate. Between the said dates, the firm drew moneys from the Bank for two purposes, (1) to pay themselves the remuneration reserved by the scheduled agreement, and (2) to pay on behalf of the Company preliminary expenses incurred by them for the Company.

The dispute arose, because in fact the scheduled agreement was not executed by the directors. The Company in the suit claimed, (1) all the moneys the Bank had paid to the firm as a consequence of the firm operating on the

Company's account, and (2) from the firm all the moneys so drawn by the firm from the Bank. The suit having been dismissed by the subordinate judge of Madura, the plaintiff company preferred the present appeal.[43]

Their Lordships Ramesam and Stone, JJ., dismissed the appeal so far as it related to the defendant-respondent Bank,[44] in the following words:

> "We are clearly of the opinion that though strangers to the Company have constructive notice of the memorandum and articles they are entitled to assume that the provisions therein contained have been complied with by the officers of the company. Here, by the articles, the Directors are directed forthwith to execute by affixing the seal of the Company to the scheduled agreement. Strangers to the Company are entitled to assume that that direction has been carried out and that as a consequence the firm were entitled to act as managing agents with the powers conferred by the scheduled agreement. The appeal as against the Bank accordingly clearly fails".(45)

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43. Counsel for the company-appellants very faintly argued the appeal as against the Bank, observing, in their Lordships' opinion, "very properly", that if the Bank could not be regarded as put on notice of the need to have the scheduled agreement executed (which notice would impose upon the Bank the duty to ascertain that the agreement was executed and the firm thereby authorised) the case was covered by _Mahony_ v. _East Holyford Mining Company_, (1875) 7 Eng. & Ir. Reports, 869.

44. The appeal so far as it related to the defendant respondent firm was also dismissed, but that decision is not relevant for our purposes here.

45. 68 M.L.J.R. 510, at pp. 513-514.

Thus the appeal against the Bank was dismissed. This case is different from the others discussed so far inasmuch as in those cases the managerial personnel concerned were duly appointed agents of the company, whereas in the present case they were not. Even then the Court held the Company bound by their acts because they had a de facto status.

In P.V. Damodara Reddi v. Indian National Agencies Ltd.,[46] the facts were that P.V. Damodara Reddi and D.Duraiswamy Nayudu had separately applied in writing for shares in the Indian National Agencies, Ltd., Their applications were considered at a meeting of the directors of the Company held on 12th April, 1942. The applications for shares appeard to have been made in February, 1942. Each of the applicants was allotted two shares at the meeting of 12th April, 1942, and the minutes of that meeting recorded that, upon these allotments having been made, the two applicants joined the meeting as directors of the Company. Besides the remainder of this first meeting, the applicants were said to have been present at a number of other subsequent meetings. The applicants were duly entered on the register of members of the Company. Some eight months later, in about December, 1942, the directors of the Company resolved to cancel the allotment of these shares to the applicants, and removed

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46. (1945) II M.L.J.R. 432, decided by Clark, J., of the Madras High Court in the Ordinary Original Civil Jurisdiction of that High Court.

the names of the applicants from the register. The present applications were for rectifying the register by re-inserting the names of the applicants. Both the applications were heard together.

His Lordship, Clark, J., was of the opinion that it was possible for him to allow these applications on the simple ground that if these members' names had been improperly added to the register, the remedy of the Company was to apply to this Court under section 38[47] for rectification of its register and not to take upon itself to alter the register in the manner they did. But this the learned Judge did not do because of the probability in that case of the Company bringing a suit for rectification of the register, as indicated, and so in order to avoid unnecessary litigation the learned Judge proceeded to decide the applications on the merits of the validity or otherwise of the allotment of the shares to the applicants.

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47. Now s. 155 of the Companies Act, 1956. The relevant portions of s. 38 of the Indian Companies Act, 1913 were as follows:

"(1) If -

(a) the name of any person is fraudulently or without sufficient cause entered in or omitted from the register of members of a company; or

(b) default is made or unnecessary delay takes place in entering on the register the fact of any person having ceased to be a member, the person aggrieved, or any member of the company, or the company, may apply to the Court for rectification of the register".

The Company claimed that these allotments were invalid by reason of the provisions of article 5 of the articles of association. That article provided as follows: "The shares shall be under the control of the directors who may allot or otherwise dispose of the same only among the existing members but shall not without the consent of the Company in general meeting allot or otherwise dispose of them to outsiders." It was said that as these allotments were made by the directors to outsiders without consent of the Company in general meeting, they were accordingly void and wholly inoperative. Further, it was urged on behalf of the Company that the applicants must be deemed, whatever might have been the fact, to have contracted on the footing of the articles of association including article 5.

His Lordship thought that this case was covered by the rule laid down in the Royal British Bank v. Turquand, and held:

> ". . . I hold the applicants were entitled to assume that the directors were acting regularly and that the sanction of the Company in general meeting had, in fact, been obtained. That being so, the allotments cannot now be avoided by the company and the applicants must be regarded as persons who agreed to become members of the Company. This added to the fact that their names had been added to the register of members, constitutes them members of the Company, and, as such, they are entitled to have their names re-entered on the register of the members from the date on which they have been improperly removed". (48)

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48. (1945) II M.L.J.R. 432, at pp.434-435.

Thus the company was held bound by the allotment of shares to these applicants even though the allotment was in excess of the authority of the directors. The attempt of the company to efface the consequences of this excess was frustrated by the Court by allowing these applications for rectification of the register.

In _Dewan Singh Hira Singh_ v. _Minerva Films Ltd._,[49] a petition was presented for rectification of the respondent Company's register under section 155 of the Companies Act, 1956. But the purpose of this petition was not inclusion in, but exclusion of some names from, the register. The petitioner was one of the directors of the Company and he prayed for rectification of the register by dropping out the names of some shareholders to whom, he alleged, shares were alloted by the Board of Directors in an unauthorised manner.

Tek Chand, J., after discussing _Royal British Bank_ v. _Turquand_ and its progeny of cases including the case last discussed,[50] observed:

> "In this case the transactions which have been impugned, x took place some years ago. The petitioner, who was present and who was presumed to be aware of the restricted authority of the directors, had not chosen to bring that fact to the notice of the intending purchasers. It is not his case that they were aware that the

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49. A.I.R. 1959 Punj. 106.

50. _P.V. Damodara Reddi_ v. _Indian National Agencies Ltd._, (1946) 2 M.L.J.R. 290.

> directors were authorised to allot not more that 5,000 A class shares. After receiving payments to the full value of the shares, and after a passage of long time, it is not open to the Company, least of all to Dewan Singh, petitioner, to question the legality of a transaction to which he was a party". (51)

The petition to rectify the register was dismissed and thus an attempt of one of the directors to undo the consequences of excess of authority by the Board of Directors was foiled by the Court.

In L.R. Cotton Mills Co. Ltd. v. J.K. Jute Mills Co. Ltd.,[52] the plaintiff's case was that the plaintiff Company had advanced a loan of Rs.1,50,000 to the defendant Company on the understanding that the loan advanced would carry interest 1% higher than the current Bank rate, and would be repaid together with interest within six months. Sri Gulab Chand Jain, one of the directors[53] of the defendant Company, sent a letter on 24.12.1951 to Sir Padampat Singhania, the governing director of the plaintiff Company, to advance the said loan. Sri Gulab Chand Jain also sent an advance receipt to the plaintiff Company along with the above-noted letter. Thereupon, the plaintiff

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51. A.I.R. 1959 Punj.106, at pp.109-110.

52. A.I.R. 1957 All. 311, decided as first appeal by Desai and Beg, JJ., of the Allahabad High Court.

53. He was also a director of the Managing Agency Company of the defendant and, moreover, he was a delegate to whom all the powers of the Managing Agents had been delegated.

advanced a sum of Rs. 1,50,000 as a loan to the defendant on 26.12.1961, through a cheque, dated 26.12.1961, drawn on the Hindustan Commercial Bank Ltd., in favour of the defendant. A covering letter of the same date was also sent by the plaintiff to the defendant along with the above-noted cheque stating that the said loan was repayable within six months with interest which was to be one per cent higher than the current Bank rate. After the expiry of the stipulated period of six months, the defendant failed to pay the loan in spite of reminders sent to it. Therefore, the plaintiff filed the present suit praying for a decree in respect of the loan. The trial court decreed the plaintiff's suit. Dissatisfied with the said decree, the defendant filed this appeal before the Allahabad High Court.

The only point that survived for contest between the parties was the defendant-appellant's plea that the loan could not be held to be binding on them as no resolution sanctioning the said loan was passed by the defendant's Board of Directors. Articles 72 and 73 of the Articles of Association of the defendant Company authorised the directors to borrow money within certain limits on such terms and conditions as they thought fit. Article 140 empowered the directors to delegate their power to such member or members of their body as they thought fit.

Their Lordships, Desai and Beg, JJ., held:

> "Under the above circumstances, even supposing that there was no actual resolution authorising him (54) to enter into this transaction on behalf of the defendant Company . . . by the Board of Directors . . . the claim of the plaintiff who was a creditor cannot be affected". (55)

Elaborating the reasons for their decision, their Lordships observed that a creditor dealing with a trading company which the defendant company happened to be, was required by law to be conversant with the terms of its Memorandum and Articles of Association and no more. If it was found that the transaction of loan into which the creditor was entering, is not barred by the charter of the company or its Articles of Association, and could be entered into on behalf of the company by the person negotiating it, then he was entitled to presume that all the formalities required in connection therewith had been complied with. If the transaction in question could be authorised by the passing of a resolution, such an act was a mere formality. A bona fide creditor, in the absence of any suspicious circumstances, was entitled to presume its existence. A transaction entered into by the borrowing

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54. That is, Mr. Gulab Chand Jain, the director who entered into the transaction of loan on behalf of the defendant company.

55. A.I.R. 1957 All. 311, at p. 314, Col. 1.

company under such circumstances cannot be defeated merely on the ground that no such resolution was in fact passed. The passing of such a resolution was merely a matter of indoor or internal management and its absence, under such circumstances, could not be used to defeat the just claim of a bona fide creditor. A creditor, being an outsider or a third party and an innocent stranger, was entitled to proceed on the assumption of its existence; and was not expected to know what happened within the doors that were closed to him. "Where the act is not ultra vires the statute or the company such a creditor would be entitled to assume the apparent or ostensible authority of the agent to be a real or genuine one. He could assume that such a person had the power to represent the company and if he in fact advanced the money on such assumption he would be protected by the doctrine of internal management".[56]

In the course of their judgment, their Lordships discussed a number of English[57] and Indian cases, including Royal British Bank v. Turquand.

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56. A.I.R. 1957 All. 311, at p. 314, col. 2.

57. On behalf of the appellant, strong reliance was placed on two cases, namely, Houghton & Co. v. Nothard, Lowe and Wills Ltd., 1927, 1 K.B. 246 and Kreditbank Cassel G.m.b.H. v. Schenkers, Ltd., 1927, 1 K.B. 826. Their Lordships distinguished both these cases from the present case. In the former case, their Lordships thought, the transaction was of an unusual kind and there were, on the face of it, facts which should have put the plaintiff on suspicion, and in spite of this,

In Iron Traders (Private) Ltd. v. Hiralal Mittal,[58] one of the two questions which survived for determination and the question relevant for the purposes of the present Chapter was whether the transfer of 133 shares of the Iron Traders (Private) Ltd., in the name of Hiralal Mittal, respondent No. 1, was validly cancelled by the Company. The counsel for the company contended that respondent No. 1 was registerd a transferee by the company in violation of its Articles of Association.[59] Therefore the registration was *ultra vifes* and could be legitimately cancelled by the company subsequently, as was done in this case.

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57. contd......
the plaintiff did not make any enquiry at all. In the present case, in their Lordships' opinion, no such suspicious circumstances existed. The second case was also distinguished as, in that case, the transaction was gone through not at all by the directors but by a branch manager; and this branch manager had acted in fraud of the company, and had committed forgeries in the perpetration of the fraud. In the present case, the transaction was not entered into by a branch manager, but by a director. "Moreover it is not alleged by the defendant that Sri Gulab Chand Jain, the director, had acted in fraud of the company". *Ibid.*, at p.315 col.1.

58. A.I.R. 1962 Punj. 227, decided as Second Appeal by Shamsher Bahadur, J., of the Punjab High Court.

59. The Articles of Association of the company laid down that a shareholder intending to transfer his shares could sell them to existing shareholders and could sell them to outsiders only when he gave a notice to the company and the company could not find a purchaser for his shares from among the existing shareholders. The first respondent was an outsider but was registered a transferee by the company even though the transfer was not in compliance with these provisions of the Articles.

His Lordships, Shamsher Bahadur, J., did not accept this contention and while distinguishing between acts which were ultra vires and those for the validity of which certain formalities were necessary, he put this act in the latter category.

Putting reliance on the rule in Royal British Bank v. Turquand, his Lordship held that "it was not incumbent on the first respondent to make an inquiry whether the Directors had complied with the formalities before registering the transfer,"[60] "and further "it could rightly be presumed by the first respondent that the company could not find any willing member to take over such a large number of shares".[61]

Thus the court held the company bound by the registration of transfer even though it was effected by the directors in contravention of the Articles of Association.

In all these cases, the Indian Courts, following the rule in Royal British Bank v. Turquand, held the companies concerned bound by the acts of their managerial personnel, though the acts of the latter were in excess of their authority. But this rule admits of some exceptions also, in which cases the outsiders concerned are not given

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60. A.I.R. 1962 Punj. 277, at p. 280, Col. 1.

61. Ibid

the benefit of the rule.

EXCEPTIONS TO THE RULE IN ROYAL BRITISH BANK V. TURQUAND.

If the outsider actually knows that the managerial personnel are exceeding their authority or are acting irregularly or the outsider is put on inquiry to know the actual facts but enters into the transaction without making this inquiry, he is not protected by this rule. Thus benefit of this rule was refused in Anand Behari Lal v. Dinshaw and Co.[62] to an outsider who had taken a transfer of a banking company's property from its accountant, the latter having no authority to execute the transfer. The grounds for refusal were: "We are not here considering the claim of a transferee who was a stranger to the Bank, but one who had probably been familiar with its character from its very inception; and who knew at least something about its constitution and was acquainted with the fact that its Managing Director had died only 16 days prior to the transfer".[63]

Also, benefit of this rule was refused to a company, E.D. Sassoon & Co., Ltd., in the case T.R. Pratt (Bombay) Ltd. v. E.D. Sassoon & Co. Ltd.[64] The grounds for refusal were:

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62. (1942) 12 Comp. Cas. 137, decided on April 7, 1942 by Bennett and Agarwal, JJ., of the Oudh Chief Court.

63. Ibid., at p. 150.

64. (1936) 6 Comp. Cas. 122, decided in appeal against the judgment of Kania, J., by Beaumont, C.J., and Wadia, J.

"The Sessoons also were bound to inquire into the title to their mortgage, and the title to the mortgage was based upon the validity of the resolution. There was no independent board, and no meeting of the shareholders was called to ratify the transaction. Therefore, under all the circumstances, the Court can impute knowledge of the irregularity to Sassoons".[65]

In Hope Mills Limited v. Sir Cowasji J. Readymoney,[66] Justice Beaman expressed the opinion that this rule "would require modification, where the persons sought to be affected with notice are themselves within the Company and, therefore, presumably responsible for its indoor management, a distinction so obvious that it would hardly, I should have thought, require judicial authority".[67]

Another often-stated[68] exception is that the Turquand rule does not apply to a forgery. It arises from

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64. contd........
    Both the learned Judges delivered separate judgments.
    Kania, J., had given the benefit of the rule to the company (Sassoons) but his judgment was reversed by the division bench. This judgment of the division bench was upheld by the Privy Council in T.R. Pratt (Bombay) Ltd. v. M.T. Ltd., A.I.R. 1938 P.C. 159.

65. (1936) 6 Comp. Cas. 122, at pp.140-141. Emphasis supplied. This passage has been taken from the judgment of Wadia, J., but similar were the views of Beaumout, C.J., also. See Ibid., pp.130-131.

66. (1911) 13 Bom. L.R. 162.

67. Ibid., at p. 181.

68. See Gower, op. cit., at p. 157.

the decision of the House of Lords in Ruben v. Great Fingall Consolidated,[69] where Lord Loreburn observed: "It is quite true that persons dealing with limited liability companies are not bound to inquire into their indoor management and will not be affected by irregularities of which they have no notice. But this doctrine, which is well established, applies only to irregularities that otherwise might affect a genuine transaction. It cannot apply to a forgery".[70] Further, Varkey Souriar v. Keraleeya Banking Co. Ltd.[71] decided that the Turquand rule did not apply where the question was not one as to the scope of the power exercised by an apparent agent but was in regard to the very existence of the agency.

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69. (1906) A.C. 439, H.L. In this case a company secretary had issued a share certificate to which he had affixed the company's seal and had forged the signatures of the directors purporting to show that the seal was affixed in their presence. A transferee claimed damages from the company on the basis that the rule of estoppel prevented the company from denying the truth of the certificate.

70. (1906) A.C. 439, at p. 443. But Gower, op.cit., at p. 157 says that this observation was a mere dictum. According to him it was "held that the document was a forgery and that therefore it could not bind the company unless some official acting within his authority had warranted that it was genuine. Even assuming that the secretary might be taken to have impliedly warranted this, he had no colour of authority, actual, usual or apparent, to do so and therefore the company was not bound. The case, therefore, decides no more than that the acts of the secretary were outside the scope of his authority, which as we have seen is an extremely restricted one". Gower, op.cit., at p.157 Emphasis added.

71. (1957) 27 Comp. Cas. 591, decided on December 12, 1956 by Vardaraja Iyenger, J., of the Kerala High Court. In this case, a hypothecation bond executed by a debtor of Keraleeya Banking Co. Ltd. was assigned by a former managing director whose resignation had been recorded by a resolution of the board of directors of the company

CONCLUSION

One thing emerges very clearly from the preceding discussion. And that is that the Indian Courts did not, while giving the outsider the benefit of the Turquand rule, inquire into whether he had knowledge of the Article (at the time of dealing with the agent of the company), which clothed the agent with apparent authority. This shows that in the opinion of Indian Judges, to have the benefit of an Article which clothes an agent with apparent authority, outsider's knowledge of the Article at the time of his dealing with the agent of the company is not necessary. Thus, the trend of opinion in Indian Courts is in line with the following opinion expressed in the Note appended by the reporter of British Thomson-Houston Company, Limited v. Federated European Bank Limited[72]: "It is submitted that actual knowledge on the part of the plaintiff of the contents of the articles of association is irrelevant except to an issue raised as to his bonafides".[73]

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71. contd........
a week before the assignment. It was held that it was no doubt true under Turquand rule that if there was a managing director and authority in the articles for the directors to delegate their power to him, then the outsider might assume that it was within the duties of the managing director to do what he purported to do. But this rule did not apply where the question, as here, "is not one as to the scope of the power exercised by an apparent agent of the company but is in regard to the very existence of the agency". See ibid., at p. 594.

72. (1932) 2 K.B. 176.

73. See the reporter's Note at the end of the report of this case which concluded with the words quoted in the text.

The law in U.S.A. goes still further. There, the by-laws (counterpart of Articles of Association) are considered internal to the Corporation and are not publicly filed.[74] In that country, by the great weight of authority, "if a corporation clothes an officer or agent with apparent authority to bind it by a particular contract or act, it cannot escape liability by setting up limitations or

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73. contd........

In an editorial note in (1932) 48 L.Q.R. 461, the learned editor of the Law Quarterly Review agreed with this view (of the reporter) and this view was also approved by Prof. H.Goitein, in his book, Company Law, (2nd ed. 1949) at p.100. Sir F.Gore-Browne's Handbook on the Formation, Management and Winding up of Joint Stock Companies, (41st ed. 1952) also prefers this view, vide pp.441 and 443. Mr. Arthur Stiebel in his article, "The Ostensible Powers of Directors", (1933) 49 L.Q.R. 350 at p. 354, expresses his approval of this view in the following words: "It is submitted that the right view is that a person may rely on an article he has not seen". Further, Wright, J., held in Kreditbank Cassel G.m.b.H. v. Schenkers, Limited, (1926) 2 K.B. 450, that in order to get the benefit of an Article which clothes an agent with apparent authority, outsider's knowledge of the article (at the time of his dealing with the agent) was not necessary. British Thomson-Houston Company, Ltd., v. Federated European Bank, Ltd., (see supra, note 70) is also understood as laying down the same thing.

But the Court of Appeal in Houghton and Company v. Nathard, Lowe and Wills, Ltd., (1927) 1 K.B. 246 and Kreditbank Cassel G.m.b.H. v. Schenkers, Ltd.,(1927) 1 K.B. 826, and Slade, J., in Rama Corporation, Ltd. v. Proved Tin and General Investments, Ltd., (1952) 2 Q.B. 147, held to the contrary. Mr. J.L. Montrose in an article, "The Apparent Authority of An Agent of A Company", (1934) 50 L.Q.R. 224; Dr. D.G. Rice in an article, "Power of A Director to Bind the Company",(1959) J. Bus. L. 332; and Dr. R. Powell in his book, The Law of Agency, (2nd ed. 1961) at p. 115, are also of the contrary view. To Mr. I.D. Campbell, "Contracts with Companies II - The Indoor Management Rule", 76 L.Q.R. 115, 125 (1960), the "law appears now to be settled, by the decisions in Houghton (supra) and Rama (supra),

restrictions upon his authority contained in by-laws not known to the third party. Persons dealing with the officers or agents of a corporation, acting within their apparent authority, are not bound to ascertain whether such apparent authority is restricted by the by-laws. They are regarded as mere internal regulations, binding as between the corporation, its officers and shareholders. But third persons dealing with an agent or representative are not affected unless they have actual knowledge of such restrictions".[75]

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73. contd.....

that the rule of indoor management does not assist the claimant where he had no actual knowledge of a power to delegate . . ."

The English Court of Appeal in a recent case, Freeman & Lockyer (A Firm) v. Buckhurst Park Properties (Mangal) Ltd.,(1964) 2 W.L.R. 618; (1964) 34 Comp. Cas. 405; sought to bring about a reconciliation between these two opposing views. The Court of Appeal in this case distinguished between unusual and normal transactions and held that knowledge of the Article was necessary in the former case but not in the latter. In this case, as the Court of Appeal held the transaction to be of normal type, they held that the plaintiff's ignorance of the Articles was immaterial. Pearson, L.J., towards the end of his judgment observed, that to insist on the plaintiff's knowledge of the Articles in the case of normal transactions, "would be an absurd example of legal pettifoggery". — see (1964) 34 Comp. Cas. 405, at p. 421.

74. See Baker and Cary, Cases and Materials on Corporations, p. 30, note 1 (3rd ed. 1958).

75. See Ballantine, Corporations, p. 262 (Rev. ed. 1946). Also see Ballantine, Lattin and Jennings, Cases and Materials on Corporations, p. 153 (2nd ed. 1953).

Now coming to the question of formulating the basis of *Turquand* rule, on which opinions are divided in England,[76] the conclusion drawn before from the Indian decisions, points out that the basis of the rule in *Turquand* case should not be estoppel. It is because, in the event of the basis of the rule being estoppel, outsider's knowledge of and reliance on the representation contained in the Article would have been essential before his getting the benefit of the Article; while, as has been seen in the preceding discussion of Indian cases, outsider's knowledge and reliance have not been considered to be at all necessary.

But as a matter of fact, there is not much necessity of relying solely on an inference about the basis of this rule; as express pronouncements regarding the basis of the rule have also been made in some Indian decisions.

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76. Slade, J., in *Rama* case (supra, note 71) thought that *Turquand* rule was based on estoppel; see Palmer's *Company Law*, p. 249 (20th ed. 1959). The same appears to be the view of Mr. J.L. Montrose, *loc. cit.*, *supra* note 73.

But Professor Gower, *op.cit.*, at p. 143 thinks "this *rule* was manifestly based on business convenience . . ." Dr. R.R. Pennington also, in his treatise, *The Principles of Company Law*, at pp. 82, 83 (1959) favours the same view and at p. 84 he concludes that ". . . the rule in *Turquand's* case does not depend on estoppel". According to Mr. I.D. Campbell, *loc. cit.*, pp. 115, 116, it is not an adequate foundation for the *rule* to say that the rule is an application of the principle of estoppel, or that the *rule* is an application of the maxim *Omnia praesumuntur rite esse acta*. He thinks that the "rule is, indeed, unique, having affinities in other legal principles, but having no precise analogy in the law applicable to transactions between natural persons".

These pronouncements are:

In T.R. Pratt, Ltd. v. E.D. Sassoon & Co. Ltd.,[77] the reason for the rule was stated in the following words:

> "The reason for the rule, I take it, is that it would be disastrous in a business community if contracts made with companies could be impeached on account of matters known to the company but not to the other contracting party". (78)

In Dewan Singh v. Minerva Films Ltd.,[79] the intention of the rule was stated in the following words:

> "The intention of the rule is to protect particularly outsiders dealing with the company, who, in the absence of knowledge, are entitled to assume that *omnia rite et solemniter esse acta*". (80)

In a more recent case, Iron Traders (Private) Ltd. v. Hiralal Mittal,[81] the basis of the rule was stated in the following words:

> "This principle sometimes expressed as the doctrine of indoor management is designed to protect innocent persons who are acting *bona fide* in the belief that the company is transacting business in accordance with its articles". (82)

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77. (1936) 6 Comp. Cas. 122, see note 64, *supra*.
78. *Ibid.*, at p. 128. This passage appears in the judgment of Beaumont, C.J.
79. A.I.R. 1959 punj. 106; see note 49, *supra*.
80. *Ibid.*, at p. 109, col. 2.
81. A.I.R. 1962 Punj 277; see note 58, *supra*
82. *Ibid.*, at p. 280, col. 1.

On the basis of these express pronouncements and also in view of what has been said above in this regard, it can safely be said that the Indian Courts consider the rule in Turquand's case to be founded not on estoppel but on considerations of business convenience and justice.[83]

Thus in India, the English rule of Royal British Bank v. Turquand,[84] even more than in England, reduces the risk for outsiders in having business dealings with limited liability companies by influencing the Indian Courts in favour of holding the companies bound by the acts of their managerial personnel even though in excess of the actual authority of the managerial personnel.

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83. See note 76 and its text, supra.

84. See note 73, supra.

CHAPTER 2

EXCESS OF AUTHORITY AND RATIFICATION

In the last chapter, we have seen how the acts of managerial personnel in excess of their authority were held to be binding on their companies because those fact-situations fell within the purview of the rule in Royal British Bank v. Turquand.[1] The aim of this chapter is to examine as to how and in what circumstances does ratification cure the defect of excess of authority by managerial personnel of companies. Before taking up our main enquiry, it will be instructive to understand as to what is meant by ratification generally.

MEANING OF RATIFICATION

According to an American treatise, "Ratification . . . represents a legal concept in the law of agency describing the relations between the parties after affirmance by a person of a transaction done or purported to be done for him".[2] The same learned treatise defines "ratification"

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1. 5 El. & Bl. 248; 6 El. & Bl. 327.

2. See Restatement of the Law, Agency, § 82, Comment a (2nd ed. 1958).

as the "affirmance by a person of a prior act which did not bind him but which was done or professedly done on his account, whereby the act, as to some or all persons, is given effect as if originally authorized by him".[3] Then, "affirmance" is defined as "either (a) a manifestation of an election by one on whose account an unauthorized act has been done to treat the act as authorized, or (b) conduct by him justifiable only if there were such an election".[4]

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3. See *ibid.*, § 82. Speaking about ratification, the same treatise further says: "The concept of ratification is not a legal fiction, but denotes the legal consequences which result from a series of events beginning with a transaction inoperative as to the principal, and ending in an act of validation. The statement that there is a relation back to the time of the original act is fictitious in form, but in effect it is a statement of liabilities. The concept is unique. It does not conform to the rules of contracts, since it can be accomplished without consideration to or manifestation by the purported principal and without fresh consent by the other party. Further, it operates as if the transaction were complete at the time and place of the first event, rather than the last, as in the normal case of offer and acceptance. It does not conform to the rules of torts, since the ratifier may become responsible for a harm which was not caused by him, his property or his agent. It cannot be justified on a theory of restitution, since the ratifier may not have received a benefit, nor the third person a deprivation. Nor is ratification dependent upon a doctrine of estoppel, since there may be ratification although neither the agent nor the other party suffer a loss resulting from a statement of affirmance or a failure to disavow. However, in some cases in which ratification is claimed, the principal's liability can be based upon unjust enrichment or estoppel, either in addition to or as alternative to his liability based on ratification". See *ibid.*, Comment c.

4. See *ibid.*, § 83.

But it should be clearly understood that there is not a change in legal relations as if there had been initial authorisation, and hence there is no ratification unless an act has been done which the purported or intended principal could have authorised, by one who purported to act as agent or intended to act as servant; and unless the act is affirmed, while still capable of ratification, by a person who, at the time of affirmance, knows the facts, who can authorise such an act, and who is the person for whom the agent purported or intended to act.[5]

An English treatise defines ratification as "the affirmance by P of an act done by A on P's behalf without P's authority. A may or may not be P's agent already."[6] Pointing out briefly his conclusions about ratification, the learned auther of this treatise says: "(1) Ratification does not create the relation of principal and agent. That relation depends on agreement, and a one-sided adoption by P of A's unauthorised act cannot produce an agreement. (2) Ratification gives, for most purposes, the effects of authorisation to the unauthorised act. (3) Ratification affects not only the relation between P and T (with whom A has purported to deal on P's behalf), but also the relation

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5. See *Ibid.*, § 82, Comment e.

6. See Powell, *The Law of Agency*, at p. 120 (2nd ed. 1961).

between A and T and, in certain circumstances, the relation between P and A".[7]

Distinguishing "ratification" from the allied concept of "acquiescence", another English treatise says: "Ratification is sometimes regarded as a species of acquiscence. It appears, however, to be clear that acquiscence implies assent of a less express character than that conveyed by ratification, and that it is not confined to active and intelligent consent, but includes mere inaction in spite of notice. Neither imply any special formality and may be presumed from conduct".[8]

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7. See _ibid_. Speaking about ratification, Dr. Powell further says: "Nevertheless, it has always defied analytical treatment. It is itself an anomaly and some of its rules are anomalous. The doctrine itself rests on a simple factual basis: 'It is true that you did this act without my consent, but now I give my consent'. The law therefore pretends that consent was given from the very beginning. It may — and indeed English law does - insist on the fulfilment of certain conditions before this fiction will be allowed to operate. Above all, the fiction is not — or at any rate, should not be — allowed to operate where it would lead to absurd or unjust consequences". — See _ibid._, at pp. 121-122.

   During his discussion of this concept, Dr. Powell proceeds to add: "Ratification can be implied either from acts or from silence or acquiescence by the principal, showing his intention to adopt the unauthorised act. However, the principal's conduct, whether positive or negative, must be clear and unequivocal in its character. It must be remembered also that the principal should have full knowledge of the facts. Indeed, it is easier to establish ratification by conduct if there is something positive upon which to build. Positive unequivocal acts referring clearly to the act in question are the most satisfactory examples" - See _ibid._, at p. 136.

8. See Street, _A Treatise on the Doctrine of Ultra Vires_, at p. 390 (1930).

In India, provisions about ratification are contained in Sections from 196 to 200 of the Indian Contract Act, 1872.

Section 196 introduces the doctrine of ratification in the following words: "Where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratify (sic) them, the same effects will follow as if they had been performed by his authority". Then Section 197 explains that ratification "may be expressed or may be implied in the conduct of the person on whose behalf the acts are done". But Section 198 warns that no "valid ratification can be made by a person whose knowledge of the facts of the case is materially defective".

Then Section 199, speaking about the effect of ratifying an unauthorised act forming part of a transaction, lays down that a "person ratifying any unauthorised act done on his behalf ratifies the whole of the transaction of which such act formed a part". The last Section of this group of Sections, namely, section 200 lays down a rule for protection of third persons in the following words: "An act done by one person on behalf of another, without such other person's authority, which, if done with authority, would have the effect of subjecting a third person to damage, or of terminating any right or interest of a third person, cannot, by ratification, be made to px have such effect".

But these provisions in regard to ratification generally, which are suitable when the principal is an individual human being, present some special problems when made to apply to a principal having an aggregate character[9] and a limited capacity,[10] which limited liability companies really are. What these special problems are, will be clear when we discuss the cases to which the doctrine of ratification has been applied in the field of company law. The application of this doctrine in Indian company law has been much influenced by the mode of its application in English company law. It is therefore proposed to examine first three leading cases on this topic decided by the English Courts.

SOME CASES ON RATIFICATION DECIDED BY ENGLISH COURTS

The first of these cases, in point of time, though not necessarily in order of importance, is Irvine v. Union Bank of Australia.[11] The suit in this case was brought by the Union Bank of Australia in the Court of the Recorder of Rangoon. The suit was to recover the sum of £ 15,296. 17s. 6d., for money advanced by the Bank to the Oriental

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9. A company does not have a body or a soul. It consists of an aggregate of several individual human beings whose collective will expressed in certain specified manners is treated to be the will of the company as a corporate being.

10. A company has a limited capacity to bind itself, unlike a normal adult human being. This is because of the doctrine of ultra vires, for which please see Part I of this thesis.

11. (1877) 2 A.C. 366 P.C.; (1878) 3 I.L.R. Cal. 280 P.C.

Rice Company and to enforce an equitable mortgage on certain premises situated in Rangoon as a security for the advance, against the said Company and against the defendant William Irvine. William Irvine was the purchaser of Company's rights and interest in the mortgaged property at a sale in execution of a decree obtained against the Company by other creditors.

The Oriental Rice Company was formed at Melbourne under an Act of the Legislature of Victoria, corresponding in its provisions to the English Companies Act, 1862, which, in its turn, had provisions corresponding to the Indian Companies Act, 1866. By Article 50 of the Articles of Association of this Company, the powers of the directors to borrow money on the credit of the Company, and to mortgage its property, were limited to a sum not exceeding in the aggregate as an existing debt at the same time one-half of the actually paid-up capital of the Company. By Article 31, these powers could be extended by a vote of one-half the share-holders given at a general meeting; and no limit or restriction was placed upon the power of the Company to borrow or mortgage.

The main question raised for determination was as to the amount for which the plaintiff held a valid charge on the property mortgaged.

The Recorder of Rangoon, in a judgment dated the 8th October 1875, held, that the directors of the Company had exceeded their powers in charging the Company's property with a debt greater than one-half of the Company's actually paid-up capital. But he was of opinion that the acts of the directors in borrowing in excess of their powers had been ratified by the shareholders. He, accordingly, gave a decree against the Company for the amount of the debt, and ordered that, in the event of the Company failing to pay, the mortgaged premises should be sold, and the proceeds applied in satisfaction of the plaintiff's claim.

The Oriental Rice Company was made co-defendant in the suit but it did not appear or defend. The present appeal to Her Majesty in Council was brought by the defendant, Irvine, who sought to have the decree of the Recorder varied by a declaration that the charge on the Company's property in favour of the Bank was valid only to the amount of one-half of the actually paid-up capital of the Company.

The judgment of the Privy Council was delivered by Sir Barnes Peacock.[12] Their Lordships took the actual amount of the paid-up capital of the Company to be £ 17,100, the amount found by the learned Recorder.

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12. Besides him, the other members present were: Lord Blackburn, Sir J.W. Colvile, Sir M.E. Smith, and Sir R.P. Collier.

It was not contended before their Lordships that the authority of the directors, either to borrow or to mortgage, was ever extended at a general meeting of the shareholders called for the purpose. But it was contended by the learned counsel for the respondents, that the limitation on the power of borrowing and of mortgaging, contained in Article 50, was merely a limitation of the authority of the directors conferred by the same Article, and, consequently, that it was not a limitation of the general powers of the Company, or of the whole body of shareholders; and that the acts of the directors in excess of their authority might be ratified by the Company and rendered binding. Their Lordships agreed with this contention and proceeded to consider whether the acts of the directors in borrowing in excess of their authority (that is, in excess of half of the paid-up capital) were ever duly ratified by the Company.

Their Lordships expressed the opinion[13] that a ratification was in law treated as equivalent to a previous authority, and that it followed that, as a general rule, a person or body of persons, not competent to authorise an act, could not give it validity by ratifying it. Their Lordhips thought[14] that it would be competent for a majority of the shareholders present at an extra-ordinary

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13. (1878) 3 I.L.R. Cal. 280, at p. 285.

14. See *ibid.*, at p. 286.

meeting convened for that object, and of which object due notice had been given, to ratify an act previously done by the directors in excess of their authority. And their Lordships were not prepared to say that, if a report had been circulated before a half-yearly meeting distinctly giving notice that the directors had done an act in excess of their authority, and that the meeting would be asked, by confirming the report, to ratify the act, this might not be sufficient notice to bring the ratification within the competency of the majority of the share-holders present at the half-yearly meeting.

But if the object was to give the directors in future an extended authority beyond what is given by Article 50, their Lordships thought that it would be an alteration of the provisions contained in Articles which, under Article 31, could only be made by a vote of one-half of all the shareholders of the Company. In their Lordships' opinion,[15] there was a wide distinction between ratifying a particular act which had been done in excess of authority and conferring a general power to do similar acts in future. This distinction must be borne in mind in considering whether the ratifications at the half-yearly meetings of particular acts done previously to those meetings gave validity to acts of a similar character done subsequently.

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15. See *ibid.*, at p. 287.

And on this question, their Lordships were of the opinion[16] that the ratification at a half-yearly meeting of a particular act in excess of authority would not extend the authority of the directors so as to authorise to do similar acts in future.

Applying these principles to the facts of this case, their Lordships, in regard to one of the two items of borrowing, expressed the opinion:

> "Their Lordships are of the opinion that the ratification of the report of 29th October 1868 did not authorize the directors to obtain the letter of credit No. 153, or to borrow the 5,000 l. now claimed as having been advanced thereon on the 11th of February 1871. The sum of 5,000 l. advanced on the 17th (sic) February 1871, on letter of credit No. 153, must, therefore, be disallowed". (17)

After this, the only item which remained to be considered was the £ 10,000, advanced on the 11th of February, 1871, on the letter of credit, No. 130. About this item, their Lordships thought:

> "But however this may be their Lordships are of opinion that there was no evidence to show that any sufficient notice of the substance or effect of the reports, which were intended to be presented at the half-yearly meetings above referred to, was given to the shareholders of the Company in pursuance of the 25th clause of the articles of association so as to lead the absent shareholders to know, or even to imagine, that the directors intended to report that they had exceeded their authority, or that, by the adoption of the report of the directors, to be laid before the

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16. See *ibid*.
17. See *ibid*., at p. 288.

meeting, an act of the directors in excess of their authority could be rendered binding upon the whole body of shareholders". (18)

Thus, their Lordships came to the conclusion that the acts of borrowing in excess[19] of the directors' authority were never duly ratified by the Company.

For these reasons, their Lordships held that the plaintiffs were not entitled as against the defendant,[20] to a

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18. See ibid., at pp. 289-290.

19. The case of the Royal British Bank v. Turquand (fully discussed in the last Chapter) was cited in the course of the argument to show that the excess of authority was a matter only between the shareholders and the directors, and that it did not affect the rights of the Bank. To this argument, their Lordships replied that in the case of Royal British Bank v. Turquand, "Chief Justice Jervis remarked that the lender, finding that the authority might have been made complete by a resolution, would have had a right to infer the fact of a resolution authorising that which on the face of the document appeared to be legitimately done. In the present case, however, the Bank would have found that, by the articles of association, the directors were expressly restricted from borrowing beyond a certain amount, and they must have known that if the general powers vested in the directors by article 50 had been extended or enlarged by a resolution of a general meeting of the shareholders under the provisions of s.31, a copy of that resolution ought, in regular course, to have been forwarded to the Registrar of Joint Stock Companies, in pursuance of s. 53 of the Companies Act, and would have been found amongst his records. Their Lordships are of opinion that the learned Recorder was correct in holding that this case is different from that of The Royal British Bank v. Turquand." See ibid., at pp. 290-291.

20. The fact that this appeal was preferred by defendant Irvine only and the defendant Company was not before the Privy Council, diminishes the importance of this

charge on the property beyond the amount of one-half of £ 17,100, the paid-up capital of the Company. Their Lordships, accordingly, advised Her Majesty that the amount allowed to the plaintiffs by the decree of the lower Court must be reduced, and that it be declared that the plaintiffs had a valid equitable mortgage on the property mentioned in the plaint for the principal sum of £ 8,550 only.

Thus this case, speaking generally, decided as follows:

(1) A company could ratify particular acts done by its directors in excess of their authority by means of an

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20. contd........

decision as an authority for cases in which borrowing by directors in excess of their authority happens to be in issue against their companies. The great Indian Judge, Justice Kania of the Bombay High Court, while refusing to follow this decision, expressed himself as follows: "The O.R. Company, who were parties to the original suit, had not appeared before the Privy Council at all. The question of directing an inquiry as to what portion was bonafide used for the benefit of the Company is not considered, nor is the question of a tracing order discussed. I am, therefore, unable to consider this decision as over-riding the general principle of law under which a principal is liable for what he actually receives, when his own powers of borrowing or receiving are not limited". - See his detailed and very learned judgment appended at the beginning of the report of T.R. Pratt (Bombay) Ltd. v. E.D. Sassoon & Co., Ltd., (1936) 6 Comp. Cas. 90. The passage quoted above appears at p.104.

ordinary resolution passed at its general meeting, provided that due notice of the excess and its requested ratification by the general meeting was given to all the shareholders; and

(2) Ratification by a company of particular acts done by its directors in excess of the authority given them by the Articles of the company, did not extend the powers of the directors so as to give validity to acts of a similar character done subsequently. For this, alteration of the Articles by the proper procedure was necessary.

The next case to be discussed here is Grant v. United Kingdom Switchback Railways Company,[21] which alone is cited by most of the English books[22] as authority for the proposition that if the directors have exceeded their authority as given to them by the Articles, then for the purpose of ratifying their past actions, as opposed to conferring powers on them for the future, it is not necessary to pass a special resolution but an ordinary resolution will suffice.[23]

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21. (1888) 40 Ch. D. 135, C.A. The Judges constituting the Court of Appeal were Cotton, Lindley and Bowen, L.JJ.

22. For example, see Gower, The Principles of Modern Company Law, note 78 at p. 128 (2nd ed. 1957); and Halsbury's Laws of England Vol. 6, note (e) at p. 415 (3rd ed. 1955).

23. This case alone is cited as authority for this proposition probably because of the fact that this case upheld this proposition in a more direct and categorical manner than the case last discussed, namely, Irvine v. Union Bank of Australia.

Thompson's Patent Gravity Switchback Railways Company, hereinafter called as T. Company, was a limited liability company, having among its objects, "(h) to promote any company for the purpose of acquiring any of the property or rights of this company . . .", and "(m) To sell the undertaking of the company, or any part thereof, for such consideration as the company may think fit . . ." The directors were not to be fewer than three or more than seven. Two directors formed the quorum. Article 100 provided, inter alia, that no director would be disqualified by his office from contracting with the company either as vendor, purchaser, or otherwise, but that no such director could vote in respect of any such contract or arrangement. Article 152 enabled the Company by special resolution to alter all or any of the regulations of the Company with certain exceptions not affecting the present case. The plaintiff was a shareholder of T. Company.

In September, 1888, the United Kingdom Switchback Railways Company, hereinafter called as U. Company, was registered as a company with limited liability. It was promoted by the directors of T. Company, and was established for acquiring and carrying on the business of T. Company so far as the United Kingdom was concerned. There were five directors of T. Company and six of the U. Company. Four persons were common to both the Boards. On the 13th

of September, 1888, a contract under the seals of the two Companies was entered into by which T. Company agreed to sell to the U. Company large part of its property.

The plaintiff brought this action against the two Companies and moved for an injunction to restrain them from carrying the aforesaid agreement into effect. The ground of the application was that the directors of T. Company had no authority to enter into the contract, as the Articles prohibited a director from voting upon a contract in which he was interested, and here all the directors but one were interested.

An extra-ordinary meeting of the shareholders of T. Company was held on the 22nd of October, at which a resolution was proposed: "That the agreement dated the 13th of September, 1888, between" (the two Companies)" be and the same is hereby approved and adopted, and that the directors be and are hereby authorized to carry into effect the same agreement". The notice summoning the meeting stated that this resolution would be proposed, but did not suggest any reason why the contract could not be carried into effect without the sanction of a general meeting. The resolution was passed, but not in such a way as to make it a special resolution.

On the 9th of November, the motion for the injunction came up for hearing and Chitty, J., being of

opinion that the T. Company had adopted the contract, refused the injunction. The plaintiff, therefore, preferred the present appeal. All the three Lord Justices delivered separate judgments.

On behalf of the appellant, it was urged that the directors could not, being interested, make a contract which would bind their company, and that a general meeting could not, by a mere ordinary resolution, affirm that contract, because this would be an alteration of the articles, which could be effected only by a special resolution.

To this, Lord Justice Cotton in his leading judgment replied:

> "This is a mistake. The ratifying a particular contract which had been entered into by the directors without authority, and as making it an act of the company, is quite a different thing from altering the articles. To give the directors power to do things in future which the articles did not authorize them to do, would be an alteration of the articles, but it is no alteration of the articles to ratify a contract which has been made without authority". (24)

It was further urged that the contract was a nullity, and therefore could not be ratified. Cotton, L.J., denied that this was true.

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24. (1888) 40 Ch. D. 135, at p. 138.

His Lordship observed:

> "That is not the case. There was a contract entered into on behalf of the company, though it was one which could not be enforced against the company. Article 100 prevented the directors from binding the company by the contract, but there was nothing in it to prevent the company from entering into such a contract. Two passages in Irvine v. Union Bank of Australia (25) were referred to. Being in the same judgment, they must be taken together, and they appear to me to express what I have said that power to do future acts cannot be given to directors without altering the articles, but that a ratification of an unauthorized act of the directors only requires the sanction of an ordinary resolution of a general meeting, if the act is within the powers of the company". (26)

It was also contended that the meeting was not good because the notice convening it gave no intimation that the contract was one which could not be carried into effect without the sanction of a general meeting. Cotton, L.J., rejected this contention also in the following words:

> "I think that the difficulty was sufficiently suggested by the mere fact of a meeting being called, for had it not been for the fact that the directors were interested, no meeting would have been necessary. But it is unnecessary to enter into that. A majority of a meeting called with due notice of the object for which it was called could make this a contract of this company, and it would be wrong for the Court to interfere with the proceedings of a general meeting as to an act within the power of the company. It is clear that a contract of this nature was within the objects of the company, and the appeal, in my opinion, fails". (27)

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25. (1877) 2 App. Cas. 366. This case has been discussed in detail before. See supra.

26. (1888) 40 Ch. D. 135, at p. 139.

27. Ibid.

As to the point last taken up, namely, the alleged defect in the notice, the other two Lord Justices said[28] they did not have anything to add to what had been said on this point by Cotton, L.J. But they expressed their separate though brief opinions on the question whether this contract was ratifiable by an ordinary resolution.

In this connection, Lindley, L.J., observed:

> "The Appellant contends that the company could not ratify this contract except by special resolution. In my opinion that contention is unfounded. There is a broad distinction between altering the articles and merely saying 'this act was not authorized by the articles, but we will ratify it'. The shareholders can ratify any contract which comes within the powers of the company, and this contract clearly does, for the articles expressly authorize selling any part of the undertaking of the company". (29)

And Bowen, L.J. was of the opinion:

> "The Appellant contends that this ratification was an alteration of the articles, and could only be made by a special resolution. That is not so. The company did not purport to alter the limits of the authority given generally by the articles to the directors. The articles limit that authority but there is nothing in them to prevent the company from giving special power to the directors in a particular case as to a particular contract. The company at a general meeting adopt this agreement, and make it their own. That is a ratification of an unauthorized act, not an alteration of the articles". (30)

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28. Ibid., at p. 140.
29. Ibid., at pp. 139-140.
30. Ibid., at p. 140.

Thus the English Court of Appeal unanimously and in very clear terms decided that a contract entered into by the directors of a company in excess of their authority as given to them by the Articles of Association, could be ratified by the company by means of an ordinary resolution passed at a general meeting, and for this alteration of the Articles by means of a special resolution was not necessary.

The decisions in these two cases[31] have attracted diametrically opposite comments. Whereas Street[32] laments the holding that an act of the directors in excess of their authority under the Articles could be ratified by the company by means of an ordinary resolution, Pennington[33] bemoans that these decisions did not go far enough to hold that the company could authorise the directors even for the future to act in excess of their authority under the Articles

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31. That is Irvine v. Union Bank of Australia, last discussed, and Grant v. United Kingdom Switchback Railways Company, presently under discussion.

32. See Street: A Treatise on the Doctrine of Ultra Vires, (1930). At p. 358, he says: "It would seem that an article limiting the powers of directors is neither more nor less binding than any other article on the corporation, and that logically no act contravening any such articles can be ratified without first changing the article. The validity of the corporate action in the latter cases is perhaps based on the power of acting independently rather than on any power of ratification".

33. See Pennington, The Principles of Company Law, (1959). At p. 396, discussing acts beyond the board's powers he observes: "The first situation where this is so

only by means of an ordinary resolution. The last of the

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33. contd........

is where the directors are unable to act because the transaction which they wish to carry out is outside their own powers. Authority for the transaction must then be sought from the members in general meeting in whom the residual powers of the company are vested, and the authorisation may be given by ordinary resolution. It has been suggested (and here he refers to these two Cases) that the members may authorise the directors to act only by ratifying the transaction after the directors have carried it out, because if the members authorised the directors to act in advance, they would be altering the articles of association, which can only be done by special resolution. This deduction is both impractical and illegical. It is impractical because no outsider would be willing to enter into the transaction with the directors knowing that the company could evade its obligations by the members simply declining to ratify what the directors had done. It is illogical because it treats the exercise of the powers conferred on the members by the articles as an attempt to extend the directors' own powers, when in reality the members, by authorising the directors to act, are merely appointing them to be their agents to exercise powers vested in the members themselves. The truth of this can be tested by asking two questions. First, would it involve an alteration of the articles if the members authorised someone other than the directors, such as some of their own number, to do the act in question on their behalf? Clearly, it would not, and logically it should make no difference that the agents chosen by the members happen to be the directors. Secondly, if the members gave authority to the directors to act in their name by a special resolution, would it be necessary to alter the articles before the authority could be revoked? Again, clearly not. If the answer were otherwise, the members would never be able to appoint agents with a merely revocable authority to exercise their powers on their behalf, and a fundamental rule of the law of agency would be flouted. It is therefore submitted that members may authorise directors to do an act which is outside the directos' own powers, but within the company's powers, by passing an ordinary resolution either before or after the directors' act; that in acting under such authority the directors act as agents for the members and not as directors of the company, and

three cases is Parker and Cooper, Limited v. Reading,[34] which solved yet another special problem posed by the application of the doctrine of ratification to companies as principals. Parker and Cooper, Limited, was an incorporated company and its memorandum authorised the borrowing of money by the issue of debentures. The Company was regulated partly by special articles filed by the Company and partly by articles contained in Table A. By special article 13 the number of directors was to be not less than two nor more than five; and by special article 18 a director might contract with and be interested in any contract made with the company, and should not be liable to account for any profit thereby made, provided that the precise nature of this interest was declared to the Board when the contract was entered into, but no director was to vote in respect of any contract or arrangement in which he was interested.

By Table A, article 76, the company's seal was not to be affixed to any instrument except by the authority of a board resolution, and in the presence of at least two directors and the secretary, which two directors and the secretary were to sign the instrument so sealed.

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33. contd.....
and consequently the members may revoke or vary the authority by ordinary resolution at any time; and that it is only necessary to amend the articles when the members wish to add to the powers of the directors as such".

34. (1926) 1 Ch. 975, decided by Ashbury, J.

Ignoring early history, we come to a period shortly before August 1, 1924. At that time, the company's bank was unwilling to increase the company's over-draft, which on February 1, 1922, the two directors, namely Arthur Parker and Elizabeth Parker, had guaranteed to the extent of £ 750. The defendant auditor[35] was consulted and on his advice it was arranged that the defendant Reading, and another director, would advance £ 1750 to the Company, out of which the £ 750 could be discharged, leaving £ 1000 for working capital. This advance was to be secured by £ 2000 debenture to Reading. This arrangement was discussed between all the four shareholders, one with another, from time to time, and they all had individually assented. The defendant auditor then instructed the company's solicitors to draw the debenture.

The arrangement was carried out at a board meeting of August 1, 1924, authorising the issue of the debenture in exchange for the £ 1750 cheque from the defendant Reading. But the sealing of the debenture was irregular within article 76 of table A, as the debenture was first sealed by director Botteril and afterwards taken to the defendant director Reading's house for signature. However, the £ 1750

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35. This was James, an accountant, who was appointed auditor of the Company and on whose advice the Company was administered.

cheque was duly paid into the Company's account and the £ 750 over-draft was discharged. On May 22, 1925, the defendant Reading appointed the defendant Auditor as receiver under his signature, and the defendant uditor took possession of the Company's undertaking and assets. On May 29, 1925, the Company passed an extraordinary resolution for voluntary winding up, and appointed the plaintiff, Palmer, as liquidator.

On September 23, 1925, the Company and the Liquidator commenced this action against the defendant Reading and the receiver for a declaration that the debenture and the receiver's appointment were invalid, and for ancillary relief. They objected that the original appointment of the defendant Reading and Botterill as directors was invalid; that they had in any case ceased to be directors before August 1, 1924; that they were — at all events the defendant Reading was — interested in the resolution authorising the issue of the debenture and therefore not entitled to vote, and there was consequently no quorum at the Board meeting of August 1, 1924, and that the seal was not affixed in the manner prescribed by the articles.

The defendants did not admit any of these irregularities, but their main defence was that every act or matter impugned by the plaintiffs was <u>intra vires</u> the

Company, and had been adopted and ratified by all the shareholders.

Counsels for the plaintiffs argued that in order that the defence of ratification may be valid, it required either a properly convened general meeting;[36] or at the very least a meeting where all the shareholders were present and formalities could be waived.[37] They contended that unless the matter was discussed at a complete meeting, there was no certainty that each member had the opportunity of ascertaining the views of all the other members.

Astbury, J., thinking that everything had been done with the utmost bona fides and solely for the benefit of the Company and that the Company had the benefit of the money, framed the question he was called upon to decide here thus: "The debenture was issued with the assent of every shareholder, and the question is whether the plaintiffs, or rather the liquidator, ought to succeed in obtaining a declaration that the debenture and the resolution authorizing it were inoperative and invalid, so that the creditors may get the advantage of the defendant Reading's 1750 l. and deprive him of the security on which he made that advance".[38]

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36. For this they referred to In re George Newman & Co., (1895) 1 Ch. 674, 684, 686.
37. For this they referred to In re Express Engineering Works, (1920) 1 Ch. 466, 470.
38. (1926) 1 Ch. 975, at p. 979.

His Lordship did not feel inclined to grant this relief unless he was bound by authority to do so. But it was suggested that in view of the decisions in In re George Newman & Co.[39] and In re Express Engineering Works,[40] his Lordship was so bound.

His Lordship then examined these cases in detail and, holding that these decisions were given on the particular facts of these cases, took the view that where the transaction was intra vires and honest, and especially if it was for benefit of the company, it could not be upset if the assent of all the corporators was given to it. His Lordship thought that it did not matter in the least whether that assent was given at different times or simultaneously.[41]

His Lordship further observed:

> "The plaintiffs contend that the two directors acted throughout as if they were partners, and cannot now turn round and shelter themselves behind the company law. I do not take this view. If company law enables the entirety of the corporators to ratify an irregular intra vires transaction why should this not protect an honest bone fide intra vires transaction entered into for the benefit of the company?
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> I can find nothing in In re George Newman & Co. (42) to prevent all the corporators from

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39. (1895) 1 Ch. 674.
40. (1920) 1 Ch. 466.
41. See (1926) 1 Ch. 975, at p. 984.
42. (1895) 1 Ch. 674, 684, 686.

> arranging to carry out an honest intra vires transaction entered into for the benefit of the company, even if they do not meet together in one room or place, but all of them merely discuss and agree to it one with another separately". (43)

Thus his Lordship held that all shareholders assenting, though not at a meeting, to a transaction _intra vires_ the Company, was a valid ratification of the _ultra vires_ acts of the directors. And on this ground, his Lordship dismissed the action of the plaintiffs.

Having thus discussed the famous trio of cases, which constantly influence the Indian decisions, we now pass on to the Indian case law on ratification of acts of managerial personnel in excess of their authority.

Indian Case Law on Ratification

The Indian cases, mostly unlike the three cases discussed above, involve "ratification" as one of the several issues and not as the sole or practically the sole issue. Here only those parts of the judgments will be discussed as relate to the issue of "ratification" only. It is proposed to take up these cases in their chronological order as far as possible.

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43. See (1926) 1 Ch. 975, at pp. 984-985.

The first of these cases is The New Fleming Spinning and Weaving Company, Ltd. v. Kessowji Naik.[44] The plaintiff Company was incorporated on the 31st July, 1878. It went into liquidation early in the year 1879, in consequence of losses sustained by the failure of Nursey Kessowji & Co., which firm had been appointed as the bankers of the said Company. The said firm had stopped payment on 26th December, 1878, having then in its hands the sum of Rs.8,80,250-14-1, belonging to the Company. In this suit the official liquidators of the Company sought to recover that sum from the defendants, who had been directors of the Company, and a further sum of Rs.2,48,670-14-0 as damages sustained by the Company through the fraud and gross negligence of the defendants in permitting Nursey Kessowji, the agent[45] of the Company, to deal with certain shares for his own purposes. The first four defendants were the directors of the Company, the fifth defendant was the assignee of the estate of Nursey Kessowji, whose firm of Nursey Kessowji and Co. had become insolvent.

By the memorandum and articles of association of the Company, the said Nursey Kessowji was appointed secretary,

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44. (1885) I.L.R. 9 Bom. 373, decided by Scott, J., of the Bombay High Court. This is a lengthy judgment and the full report of this case covers forty four pages.

45. That is the managing agent.

treasurer, and agent[45A] of the Company for a period of 25 years, upon the terms and conditions contained in an agreement referred to in clause IV of the memorandum of association and annexed to the articles of association, whereby it was, inter alia, provided that Nursey Kessowji should deposit with such banker or bankers as the directors for the time being should appoint, all the moneys due from him to the said Company, and exceeding in amount at any one time the sum of Rs.8,000.[46] On the 6th August, 1878, the directors of the Company at their board meeting passed a resolution appointing the firm of Nursey Kessowji & Co. to be the bankers of the Company.

The plaint made the following allegations, among others, in respect of this appointment: "6. The said firm of Nursey Kessowji & Co. was not a firm of bankers, but was a firm of merchants in fact and to the knowledge of the defendants, the directors, carrying a large speculative business in opium, cotton, and other commodities. The said Nursey Kessowji had a fourteen-annas share in the said firm while the other partners . . . had amongst them only a two-annas share therein. They brought no capital into

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45A. That is, the managing agent.

46. Clause XVI of the agreement. See (1885) I.L.R. 9 Bom. 373, at p. 376.

the said firm, and were merely working partners in it. The plaintiffs charge that the appointment of the said firm of Nursey Kessowji & Co. was, in substance and effect, the appointment of Nursey Kessowji to be the banker of the plaintiffs' company, and was an appointment ultra vires on the part of the defendants, the directors, contrary to the provisions of the articles of association of the said company".[47]

In their written statements, the defendants, inter alia, contended that the appointment of Nursey Kessowji & Co. as bankers of the plaintiff Company was not ultra vires on the part of the directors, that it was made by them bona fide and in the interest of the Company; and that the fact that the said firm were the bankers of the said Company was well known to the shareholders of the Company, and was acquiesced in by them.[48] Their case further was that Nursey Kessowji & Co. had been the bankers and agents of the Company to the knowledge and tacit acquiescence of the shareholders since the present Company's predecessor had come into existence.[49] The defendants

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47. See (1885) I.L.R. 9 Bom. 373, at p. 377.

48. See ibid., at pp. 380-381.

49. Here it will be useful to give a short history of the plaintiff Company. It arose out of the Old Fleming Spinning and Weaving Company, which in 1874 had sprung out of the Royal Spinning and Weaving Company. The Old Fleming Company had a capital of 18½ lakhs. In 1877,

alleged that at the date of the transfer of the business to the present Company, the commercial reputation of Nursey Kessowji & Co. was so high that it never occurred to the defendants to withdraw the confidence that had been reposed in them.[50]

His Lordship, considering these defences, held that the fact was proved that the firm of Nursey Kessowji & Co. had long been in an insolvent condition at the time

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49. contd..........
it largely increased its number of spindles by an addition of 13,300 new ones, and incurred other expenses, which altogether involved an expenditure of over 3 lakhs. To meet this new expenditure, the directors of the old company — who, with the exception of Sakerchand, were the same as the directors of the new company, (the defendants to this suit), — decided to transfer the mill and all its interests and liabilities to a new company, with an increase of capital upto 22½ lakhs. They called a meeting of shareholders of the old company, and made a report, in which they stated the object of transfer to be "an increase of the available capital of the company". This increase was to be attained by the issue of 787 shares of Rs.500 each. The rest of the shares of the new company were distributed amongst the holders of the old as the price of the transfer. The resolutions regarding the transfer were unanimously carried, and on the 31st of July, 1878, the new company was registered. The memorandum of association and the articles of association remained the same. The agreement which had been in force with the old company, setting out the terms on which Nursey Kessowji held the post of Secretary, treasurer and agent, was also continued. His firm of Nursey Kessowji and Co. had been bankers of the old company and also of its predecessors, the Royal Company. They held in their hands at the time of the transfer the sum of Rs.1,23,000, which passed under the arrangement to the new company. They continued at the transfer without any interruption to act as the bankers of the company, paying and receiving money, and on the 6th August they were formally appointed as bankers by the board. See ibid., at pp. 388-389.

50. See ibid., at p. 409.

they were named bankers of the Company.[51] Further, his Lordship thought that the directors might have ascertained the real state of things if they had made reasonable inquiry.[52] Then his Lordship proceeded to consider whether the defendant directors, or any of them, did actually know the real state of Nursey Kessowji & Co.'s affairs and came to the conclusion that the facts were sufficient to establish such intimate relations between Kessowji Naik[53] and the firm as to lead to the irresistible inference of his knowledge of the real state of their affairs.[54]

Coming to the liability of the other directors, his Lordship, about directors Gellabhoy Puddumsey and Sakerchand Nagerdas, held: "Thus they were both interested in the prosperity of Nursey Kessowji & Co. as the controlling power of the mills, and although not to the same extent as Kessowji, they did to some degree, by their appointment of Nursey Kessowji & Co. as the bankers, place themselves in a position where their interest and their duty might be in conflict, and they would be tempted to overlook misconduct".[55]

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51. See ibid., at p. 405.
52. See ibid.
53. He was one of the directors of the Company and Nursey Kessowji, the head of the bankers firm, was his son.
54. See (1885) I.L.R. 9 Bom. 373, at pp. 406-407.
55. See ibid., at p. 409.

His Lordship then directed his attention to the determination of the question as to whether this was a right and proper appointment in view of the Company's statutes, even if the directors believed the firm to be solvent.[56] And on this point, his Lordship held: "Although they did do a very small amount of banking business I do not think they could be properly chosen as bankers in the sense required by the statutes of the company; and the appointment was the more improper, as the head of the firm was the son of the principal director of the company".[57]

It was only after this holding that the appointment of this firm as bankers was in violation of statutes of the Company, that any consideration of the validity or

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56. In this connection, his Lordship observed: "Now, almost their first official act, as a board of directors, was the appointment of Nursey Kessowji & Co. as the bankers of their company. Was that a right and proper proceeding, even if they believed the firm to be solvent? Although the new company by its memorandum of association continued and confirmed Nursey Kessowji as agent, it did not continue him or his firm as its banker. We must, therefore, look to the statutes of the company, — that is to say, the memorandum, articles and agreement combined, — and consider how the banker of the company was to be chosen". — See ibid., at p. 410.

57. See ibid., at p. 411. It should be added here that the head of this bankers firm, Nursey Kessowji, was, besides being son of the principal director of the Company, Kessowji Naik, was himself a director (See ibid., at p. 375) and also managing agent of the company.

otherwise of the alleged ratification of this act of directors by the Company became relevant.[58]

This question his Lordship stated and decided in the following manner:

> "The next question of law is, whether any, and, if any, what, errors of directors can be excused by the acquiescence of the shareholders . . . . The second class applies to cases where the directors have gone beyond the powers entrusted to them; but still the acts are not beyond the objects of the memorandum of association, and may be validated by the sanction of the company. This second class is capable of ratification, and I think the nomination of Nursey Kessowji & Co. as bankers would come under that head. But there must be distinct proof of ratification in accordance with the formalities laid down by the statutes of the company, and a mere presumption of the assent of each shareholder will not be sufficient. Now in the present case the defendants have not even established a presumption. The shareholders of the company never once met during its existence. It cannot be truly said that the new company was virtually the old company under a new name. Not only were the existing shares changed into shares of a small amount, but 787 new shares were created. The acquiescence of the old company cannot, therefore, be taken to extend to its successor. No doubt at the commencement the shareholders were the same. But the list was subject to daily change by the sale of shares. There is, therefore, no proof of acquiescence, and this defence may be at once rejected". (59)

Thus his Lordship held that there was excess of authority by the directors and that this excess, though

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58. But, strangely enough, the learned Judge has considered the question of ratification before concluding that the appointment of this firm as bankers was in violation of the authority of the directors as given to them under the statutes of the Company.

59. (1885) I.L.R. 9 Bom. 373, at pp. 396-397.

ratifiable, could not be held to be ratified. This was because ratification, in order to be valid, must be in accordance with the formalities laid down by the statutes of the company, and a mere presumption of the assent of each shareholder would not be sufficient. Now in the present case, his Lordship held, the defendants had not even established a presumption of the assent of each shareholder. The defence of ratification was therefore rejected.

The next case to be discussed here is Tara Chand v. The Ganesh Flour Mills Co. Ltd., Delhi.[60] In this case the plaintiff, Tara Chand, a merchant of Bombay, sued the Ganesh Flour Mills Co., Ltd., Delhi, to recover the sum of Rs.3,000 alleged to be due to him under a deed of agreement entered into between him and the directors of the defendant Company on November 6th, 1894. The plaint set out that by the above-mentioned agreement, in consideration of the purchase by the plaintiff, upon the terms and conditions specified in the agreement, of 200 shares in the Company, the Company agreed, among other things, to pay to the plaintiff a commission of one anna per maund of bran sold by the said Company to any person other than the plaintiff for a period of 15 years commencing from

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60. (1901) Civil Case No. 17, The Punjab Record, p. 56, decided by a bench of the Punjab High Court consisting of Robertson and Maude, JJ. The judgment of this bench was delivered on 9th Dec. 1900 by Maude, J.

July 26th, 1894. As the Company had not paid the plaintiff any commission subsequent to September 30th, 1895, he claimed Rs.3,000 as approximately the amount due including interest upto the date of suing.

The defendant Company admitted that its directors had entered into the agreement in question, but pleaded, among other things, that the agreement was ultra vires of the powers of the directors to bind the Company, and that it was unreasonable and voidable, and that the Company had refused to be bound by it, and had put an end to it.

The District Judge found, among other things, that the directors had exceeded their powers, and that the Company was not bound by the agreement, as it had not ratified the acts of its directors. In appeal the learned Divisional Judge also held that the directors had exceeded their sources, but he differed from the finding of the lower court as regards the question of ratification which he held was proved.

Before the Punjab High Court, the counsel for the plaintiff appellant argued, inter alia, that (1) the agreement entered into was intra not ultra vires of the directors, and therefore the agreement was binding on the Company; and (2) even assuming that they acted ultra vires of their powers, their acts were sufficiently ratified by the shareholders.

In regard to the first of these arguments, their Lordships, after considering the relevant articles and other circumstances, held: "We have no hesitation in holding that entering into such an agreement was <u>ultra</u> and not <u>intra vires</u> of the Directors".[61]

Their Lordships then took up for consideration the second argument of the plaintiff appellant which was based on ratification.

In support of this contention, reliance was placed on two reports of the directors, dated November 14th, and April 18th, 1895, which reports were adopted by the shareholders. The reports themselves contained no allusion to the agreement in question, but in the profit and loss accounts attached to them there were entries showing payments to the plaintiff and others under the head of "commissions", while in the balance-sheet of the earlier report there was also entered a payment to him and others under the head of "concessionnaires". Beyond this, there was no proof that the shareholders were aware of the agreement or that they ever ratified its terms. On the contrary, the proceedings of an Extraordinary General Meeting, held on July 25th, 1896, appeared to indicate that the shareholders wished to undo the act of their directors. For these reasons, their Lordships held:

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61. See <u>ibid.</u>, at p. 59.

"We are clearly of opinion that there was no ratification of the act of the Directors which could bind the Company even were it proved (which it is not) that the members present at the meetings, when the two reports were adopted, were aware of the entries in the accounts. In the first place there is nothing to show how many shareholders were present, or that those present had knowledge of what was to be ratified or even any such information as would have placed them in a position to ascertain the facts as to how and why the payments to the plaintiff had been made; and, in the second place, there is the highest authority for holding that in no case could the proceedings of those meetings be deemed to bind either the absent or present shareholders". (62)

And x concluding their discussion on the question of ratification, their Lordships finally held:

"In the present case there is absolutely nothing to show that the shareholders present at the meetings, referred to, had, when they adopted the Directors' reports, any knowledge of the meaning of the entries in the accounts of payments to the plaintiff. We are thus clearly of opinion that the entering into the agreement by the Directors was <u>ultra vires</u>, and that their act was not ratified by the company". (63)

Thus their Lordships held that the act of the directors in entering into this agreement was in excess of their authority and that this excess of authority could not be said to be ratified by the Company. In their Lordships' opinion, for the plea of ratification to succeed, the plaintiff must have proved that the shareholders present

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62. See <u>ibid</u>.

63. See <u>ibid</u>., at p. 60.

at the meetings referred to, had, when they adopted the Directors' reports, knowledge of the meaning of the entries in the accounts of payments to the plaintiff. By knowledge of the meaning of the entries in the accounts, their Lordships meant not only knowledge of the payments to the plaintiff but also knowledge of the reason for the payments, which, in other words, meant knowledge of the agreement in question.

The next case to be considered here is <u>Hindustan Assurance and Mutual Benefit Society Ltd.</u> v. <u>Khalsa Bank</u>.[64] On 5th October 1917, one Diwan Mangal Sen executed a bond in favour of the Khalsa Bank Ltd. (hereinafter to be described as the bank) for Rs.50,000, which he acknowledged to be due by him to the bank on hundis and a floating account, and promised to pay the money with interest by certain instalments. It appeared that he was, at that time, the Managing Director of the Hindustan Assurance and Mutual Benefit Society Ltd., (which will be described hereinafter as the Assurance Society), and on the aforesaid date he executed also a deed on behalf of the Assurance Society, by which the Society stood surety for the payment of the debt owed by him to the bank, and hypothecated certain properties by way of security for the performance of the promise.

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64. A.I.R. 1928 Lah. 176, decided by a bench of the Lahore High Court consisting of Shadi Lal, C.J., and Bhide, J. The judgment of the bench was delivered by Shadi Lal, C.J.

The principal debtor paid some of the instalments due under the bond, and upon his failure to discharge the remaining liability, the bank brought the present action for the recovery of the amount due to it and sought to make the principal debtor as well as his surety liable for the payment of the debt. The trial Judge granted a decree against both the defendants, and that decree was not challenged by Mangal Sen. It was the Assurance Society which contested its liability as a surety and the main question debated in this appeal was whether the Assurance Society was legally bound by the contract of suretyship made on its behalf by the Managing Director.

On 23rd September, 1917, the directors of the Assurance Society had passed a resolution declaring that "the Board is willing to stand as surety for Diwan Mangal Sen's personal liability with the Khalsa Bank Ltd. and to give them lien on the Company's property if need be". It was this resolution which we recited in the surety bond by Diwan Mangal Sen, as his authority for executing the document.

For the appellant Assurance Society, it was argued that the resolution expressed only the willingness of the directors to stand surety for the debts of Diwan Mangal Sen but did not convey their final consent to the

execution of the surety bond. Their Lordships did not agree with this contention and were of the view that the aforesaid resolution "was intended to give expression, not to a mere pious wish on the part of the directors, but their decision, that the Assurance Society should become surety for the payment of the debt".[65] Their Lordships further thought that the cancellation of this resolution on 20th October 1917, did not detract from the obligation, if valid, which had already been accepted under the surety bond executed in pursuance of this resolution.

But the question, still, remained whether the directors had any authority to make the Assurance Society liable as a surety for the debt of a private person. Neither Article 112, which dealt with the general powers of the directors, nor Article 114, which specified the special powers conferred upon them, made any mention of such a contract of suretyship. It was, no doubt, true that under clause (1) of Article 114, the directors were competent "to enter into contracts for the Society and to contract on behalf of the Society, such debts and liabilities as they may in the exercise of their discretion, consider necessary in transacting the business of the Society".

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65. See <u>ibid</u>., at p. 177.

But this clause, their Lordships thought, "was obviously intended to include such acts as were necessary for the transaction of the ordinary business of the Society and for purposes incidental thereto. A contract to stand surety for the payment of a debt due by a third person cannot be regarded as an act of the above description and does not come within the ambit of the clause".[66]

After having thus held that the directors had exceeded their authority by making the Assurance Society liable as a surety, the next question which came up for decision before their Lordships was whether or not this excess was ratified by the Society. In this connection, their Lordships held:

> "But a person relying upon a ratification by the shareholders must satisfy the Court that they had full knowledge of the facts relating to the transaction to be ratified or that the means of knowledge were available to them. The learned counsel for the respondent admits that there is not a particle of evidence to show that the matter was ever placed before the shareholders, and there can, therefore, be no ratification by the company". (67)

Thus their Lordships rejected the plea of ratification on the ground that for the plea of ratification to succeed it must be shown that the shareholders had full

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66. See ibid.
67. See ibid. In this view of the case, their Lordships considered it unnecessary to examine whether the powers expressed in the Memorandum of Association conferred upon the Company any authority to enter into the contract in question. — See ibid.

knowledge of the acts relating to the transaction to be ratified or that the means of knowledge were available to them, whereas in the present case there was no evidence at all to show that the matter was ever placed before the shareholders.

A case of very great significance in this regard is M.K. Srinivasan v. W.S. Subrahmanya Ayyar.[68] The suit out of which this appeal arose related to a company known as the United India Life Assurance Co. and the circumstances which gave rise to the dispute were briefly these. The Directorate of the Company was to be composed of two policy-holders' directors, elected by the policy-holders, and of a certain number of shareholders' directors. The ordinary General Meeting for the election of shareholders' directors was fixed for the 13th October, 1930. The Articles of Association had contained a provision that the number of shareholders' directors should be six and that two should retire by rotation, their places being filled by election at the meeting. But this number had been, by amendment of the Articles, reduced to five, and it was provided as a special case, that at the General Meeting of 1930, the six directors should vacate office and that not more than five should be elected in place of them.

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68. (1932) 2 Comp. Cas. 147.

At the General Meeting, the 3rd defendant, who was at that time the Chairman of the board of directors, took the chair, and, it being decided to fill all five vacancies, a vote was taken by show of hands, and five persons were declared elected. A poll was then demanded, and the Chairman directed that it should be held at the Company's office on the 20th October and appointed the Company's manager as Returning Officer for the purpose of taking it. On the 20th October, at the appointed time, a number of shareholders assembled at the office of the Company, but neither did the Returning Officer appear, nor were any other arrangements made for holding the poll.[69] They waited there and eventually dispersed. No further attempt was made to take a poll.

In the meantime, on the 16th October, the two policy-holders' directors had appointed two of the shareholders as directors. One of the two directors thus appointed was the same person who was at that time the Chairman of the board of directors, being the third defendant in this suit; and the other director was made the fourth defendant. By these two appointments the number of directors was brought upto four, it being the minimum number required by Article 88 to act in the name of the Company. These four persons claiming to be directors,

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69. The explanation given was that the Returning Officer was unable to attend through sudden illness, and that a message which he had sent to the Chairman in the afternoon was not delivered as the Chairman had shortly before left Madras on a visit to a sick relative. — See ibid., at p. 152.

being defendants 1 to 4 in this suit, on 22nd October took the line best calculated to demonstrate their refusal to hold the poll, by co-opting three more shareholders, being defendants 5 to 7, as directors. By this appointment of three directors, the number of directors was brought upto the maximum.

Four shareholders, the plaintiffs in this suit, filed this suit on 24th October, praying, inter alia, that these appointments might be declared illegal and invalid, and that the Court should direct a poll to be taken to elect five shareholders' directors to the existing vacancies. Waller, J., who tried the suit dismissed it upon a preliminary issue. His Lordship found that the co-option, in two stages, of the five shareholders' directors was ultra vires, but that, assuming it to have been so, the Company and not the individual shareholders should have come as plaintiffs. Further, his Lordship thought that the Articles of Association provided the shareholders with an alternative remedy, and that at least until that had proved infructuous, the Court should not intervene. The present appeal was filed by all the plaintiffs against this decision.

Good deal of arguments addressed to their Lordships, Curgenven and Cornish, JJ. represented an attempt to prevent the Court from interfering on the

ground that it was a matter belonging to the domain of internal affairs of the Company and thus ousted the Court's jurisdiction to entertain a suit by shareholders.[70] This argument did not impress their Lordships and Curgenven, J., thought that "in a case where the shareholders have, through no fault of their own, been deprived of their fundamental privilege of choosing their own management, and where that management has passed into the hands of persons with no legal title to enjoy it, if ever there was a case for the Court's interposition it must be this".[71] And Cornish, J., was of the opinion: "This being the case, and there being no adequate remedy open to the plaintiffs under the articles, I think it falls within the rule that the Court has jurisdiction to entertain a suit by shareholders against the Company in respect of an infringement of their individual rights as shareholders when the interests of justice so require".[72]

In the same connection, it was further contended on behalf of the respondents that the plaintiffs, in order to rectify the position complained of, should have availed themselves of facilities afforded by the Articles of the Company. The learned trial Judge was of the view that it

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70. For this rule, known as the the rule in _Foss_ v. _Harbottle_, please see Part III of this thesis.

71. See (1932) 2 Comp. Cas. 147, at pp. 157-158.

72. See _ibid._, at p. 168.

was open to the shareholders by special resolution to remove the so-called directors from office, a course which was dependent upon securing a three-fourths majority. Gurgenven, J., considered it hardly proper to tell a shareholder who complained of acts committed in defiance of the Articles of Association that the enforcement of his legal rights was dependent upon securing such a majority.[73]

But the counsel for the respondents preferred to adopt the position that a mere majority of shareholders would be able to validate the acts performed <u>ultra vires</u> by the Chairman and his party. Gurgenven, J., considered this argument to be based upon a fallacy.

His Lordship observed:

> "It is, no doubt, true that if the Directors of a Company act <u>ultra vires</u>, and if what they have done would be within the power of the Company, acting, within its Memorandum and Articles of Association, to do, the Company can ratify the action taken. <u>It cannot so ratify it by a simple majority if by a general resolution it could not sanction such a course</u>". (74)

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73. See <u>ibid</u>., at p. 162.

74. See <u>ibid</u>., at p. 162. Emphasis added. His Lordship further observed:
"It is surely enough to point out that even a majority cannot act in breach of rules which they have agreed shall regulate their actions . . . . The Indian Companies Act gives statutory force to this principle by providing in Sect. 21 that the Memorandum and Articles shall bind the Company or the members thereof to the same extent as if they respectively had been signed by each member and contained a covenant on

Cornish, J., made the following observations:

> "It has been contended that, assuming Defendants, 3,5,6,7 and 8 have usurped the office of shareholders' Directors, this was a matter capable of confirmation by the Company in General Meeting — though no meeting of the Company has in fact sanctioned it. In other words, the argument is that the Company which means, of course, a majority of the general body of shareholders, could by a resolution over-ride the Articles which require Directors to be elected, and resolve that these five gentlemen, who have contrived to step back into office without an election should remain there. I do not think that this would be <u>intra vires</u> a general meeting of the share-holders, for the articles until altered (and this, according to Sect.20, Indian Companies Act, can only be done by special resolution), bind the shareholders in General Meeting as much as the board. . ." (75)

Their Lordships allowed the appeal and declared that the co-option of defendants 3 to 7 to the vacant posts of Directors was illegal, and that the share-holders were entitled to elect five of themselves to those vacancies. The third defendant, as Chairman, was directed to proceed with the election, and to take a poll after due notice to all shareholders within ten days of the date of this judgment.

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74. contd.........
the part of each to observe all their provisions. Accordingly to say that the course taken in the present case could have been ratified by the vote of the majority is equivalent to saying that the Articles permit the election of Directors to be made otherwise than at the Ordinary General Meeting, as Art. 68(f) provides, and otherwise than by submission of the name of all eligible candidates to the choice of the voters". — See <u>ibid</u>., at pp. 162-163.

75. See <u>ibid</u>., at p. 167.

This judgment is of very great significance as it laid down that for ratifying an act in excess of the powers of the directors as given to them by the Articles of Association, the General Meeting should pass a special resolution, and ratification of this act cannot be effected by means merely of an ordinary resolution.

It may be recalled that this is contrary to what was held in Irvine v. Union Bank of Australia[76] and more explicitly in Grant v. United Kingdom Switchback Railways Company.[77] These cases, as has been seen, decided that only an ordinary resolution was sufficient to ratify an act of the directors in excess of their authority. But the view taken in the case under discussion is in consonance with what Street had advocated in this regard.[78]

Another important case and which is very often cited in most of the subsequent cases involving ratification is Smt. Premila Devi v. Peoples Bank of Northern India Ltd.[79] These were three consolidated appeals from the order of the Lahore High Court, dated 10th March, 1936, made upon an application by the Official Liquidator of the respondents,

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76. (1878) 3 I.L.R. Cal. 280 P.C., discussed supra.
77. (1888) 40 Ch. D. 135, C.A., also discussed supra.
78. See note 32, supra.
79. (1939) 9 Comp. Cas. 1, decided by the Privy Council on October 17, 1938. The following constituted the Privy Council:- Lord Wright, Lord Romer, Lord Porter, Sir Shadi Lal and Sir George Rankin. Judgment of the Council was delivered by Lord Romer.

the Peoples Bank of Northern India,Ltd. The question to be determined was whether the appellants should be placed upon the list of contributories notwithstanding the fact that in the year 1933 the directors of the bank purported to forfeit the appellants' shares, and removed the appellants' names from the register of members in respect thereof. The Bank was incorporated in the year 1925 under the Indian Companies Act with a capital of 50 lacs of rupees divided into 50,000 shares of Rs. 100 each.

On 22nd May 1935 an order was made for the winding up of the Bank and the Official Liquidator was appointed the liquidator. By this time, the names of all the appellants had been removed from the register of members in respect of the shares which the directors had purported to forfeit. In the cases where the directors had been able to sell the shares, the names of the purchasers had been entered on the register. The Official Liquidator, however, put the names of all the appellants on the register as he thought that their shares had not been validly forfeited and that therefore their names had been improperly removed from the register. In order to have it determined whether this contention was well-founded, he applied to a Judge of the Lahore High Court to have the list of contributories settled by the Court.

The question of principle involved was in due course referred by the learned Judge to a Division Bench

consisting of the Chief Justice and Justice Munroe. They held in effect that the forfeiture of the appellants' shares was *ultra vires* the Bank and of no effect. They rejected the contention of the appellants that the action of the directors had been ratified by the creditors and shareholders, holding that such ratification, even if proved, could not validate an *ultra vires* transaction. But they further held that there was no such ratification in fact. They, accordingly, allowed the application of the Official Liquidator, and ordered the rectification of the register of members so as to include the names of the appellants and others in the like position, and settled their names upon the list of contributors. From that decision, the appellants appealed to His Majesty in Council.

Before the Privy Council also, it was strenuously contended on behalf of the appellants that the forfeitures in question had been ratified by the whole body of creditors and shareholders. Such ratification, it was said, was to be implied from the fact that various balance-sheets with reports thereon of the directors showing that the shares in question had been forfeited, had been issued to the shareholders; that the forfeiture of the shares had also been mentioned and discussed at meetings both of creditors and shareholders; and that no creditor or shareholder had ever challenged the validity of the forfeitures.

In view, however, of the binding character of the scheme[80] sanctioned by the Court, their Lordships of the Privy Council thought that no variation of or departure from that scheme could be validated by the mere acquiescence of the shareholders and creditors. But even if it be assumed that the forfeitures could be made valid by ratification, there was no evidence, in their Lordships' opinion, which could justify the conclusion that such ratification was in fact effected.[81]

Their Lordships concluded:

> "There can in truth be no ratification without an intention to ratify, and there can be no intention to ratify an illegal act without knowledge of the illegality. In the present case there is nothing whatsoever to show that in the balance-sheets or reports or at any meetings the attention of the creditors or shareholders was called to any illegality or irregularity in the forfeitures of the shares, or that at any

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80. The forfeitures in question were not in conformity with a scheme (amended scheme) duly confirmed by the Court. Their Lordships thought that upon confirmation by the Court, the scheme became by virtue of section 153 of the Indian Companies Act, binding upon the creditors, the shareholders and the Bank alike. Its terms could thereafter only be varied by order of the Court after the variation had been approved at meetings of the creditors and shareholders. "It was not therefore possible for the Bank or its directors or shareholders whether by resolution or ratification or otherwise to alter the dates fixed by cl. 6 of the scheme for payment of the 20 per cent. called upon March 1932 or the 5 per cent. called upon 18th January 1933. It necessarily follows that the resolution of the directors on the latter date requiring the whole 25 per cent. to be paid with interest on or before 26th February 1933 was an attempt on their part to do something that was _ultra vires_ the Bank". — See (1939) 9 Comp. Cas. 1, at p. 10.

81. See _ibid._, at p. 12.

> material time they had any knowledge of any such illegality or irregularity. Least of all were they told that they were being invited by their silence or otherwise to ratify the forfeitures that had taken place. It was on these grounds that the plea of ratification was rejected, and in their Lordships' opinion was rightly rejected, by the learned Judges of the High Court". (82)

Their Lordships advised His Majesty to dismiss these appeals.

This case is very often cited since after, as emphasising the important principle that there can be no ratification without an intention to ratify, and there can be no intention to ratify an illegal act without knowledge of the illegality.

Another important case which deserves detailed discussion here is Sri Balasaraswathi Ltd. v. A. Parmeswara Aiyar.[83] These were three connected appeals against the judgment and decrees of the Subordinate Judge of Tirunelveli in O.S. Nos. 131 of 1950 and 101 of 1951. The relevant facts were briefly these: One Subbiah Ayyar was doing the business of money-lending. One Sadagopal Naidu, the second defendant in both the suits, and his brother, Srinivasaga Naidu, the third defendant in O.S. No. 101 of 1951 and not a defendant in the other suit, were running some buses even

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82. See ibid., at p. 13.

83. (1956) 26 Comp. Cas. 298, decided in appeal on November 17, 1955 by the Madras High Court.

early in 1945, having purchased five buses with the help of loans from Subbiah Ayyar. On 14th December, 1945, the two brothers formed a private limited company, called Balasaraswathi Ltd., consisting only of themselves. Then they borrowed Rs.1,40,000 from Subbiah Ayyar and purchased some 16 more buses.

Under the articles of association of this private limited Company, the second defendant, Sadagopal, was the managing director and was entitled to contract debts and do all other necessary business of the Company. On 1st January, 1947, the two brothers, Sadagopal and Srinivasaga, executed a promissory note, Exhibit B-11, in favour of Subbiah Ayyar for Rs.3,97,671-7-7, the sums advanced with compound interest added at irregular intervals till that day, and promised to pay the said amount with 1 per cent. interest per month. On 16th August, 1947, Rs.1,26,400 was paid by the two brothers to Subbiah Ayyar, and this payment was endorsed on ExhibitB-11.

Soon after this, Srinivisaga filed a partition suit against his brother Sadagopal. On 10th December, 1947, this suit was compromised under Exhibit A-3, between the brothers. One of the terms of the compromise was that Srinivisaga was to take for his share eleven buses and a lorry, and their routes, and to take over liability for Rs.2,62,000 out of the debt due to Subbiah Ayyar. Accordingly, Srinivasaga Naidu executed a promissory note, Exhibit A-5, for Rs.2,62,000 to Subbiah Ayyar on 9th December, 1947, itself;

Subbiah Ayyar, of course, advancing that money by adjustment towards the money due to him from the first defendant Company and the two brothers, thereafter only looking to Srinivasaga Naidu for that portion of the debt. Srinivasaga Naidu discharged that debt in full.

After Srinivasaga Naidu had gone out of the Company, of which he was a director and a shareholder, Sadagopal took in his wife, Sithalakshmi Ammal, as director and shareholder in his place. Sadagopal continued his transactions with Subbiah Ayyar. On 28th April, 1950, Subbiah Ayyar died, leaving his widow, Vengu Ammal, and seven daughters. On 18th June 1950, the second defendant, the managing director of the first defendant Company, signed in a settlement of accounts in the pass-book, Exhibit A-7,[84] acknowledging the balance of Rs.1,76,989-14-11, as the principal amount due from him on that date. That was treated in O.S. No. 131 of 1950 as a promissory note executed by him on behalf of the Company and on behalf of himself. He also executed an agreement, Exhibit A-8, to Vengu Ammal, undertaking personal liability for the amount. According to him, this agreement was executed in favour of the estate of Subbiah Ayyar, though in the name of Vengu Ammal. He had also pledged his life insurance policy of Rs.75,000 to Subbiah Ayyar as collateral security for the debt due to him. He undertook to pay Vengu Ammal

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84. The debt due to Subbiah Ayyar from the two brothers was first entered in a pass-book, Exhibit A-1, till the formation of the Company on 14th December, 1945, and thereafter in the pass-book, Exhibit A-6, and thereafter in another pass-book, Exhibit A-7. See *Ibid.*, at p. 301.

Rs. 100 per day from the net income of the bus services till 1st March, 1951, towards the debts of Subbiah Ayyar acknowledged by him, and Rs.150 per day after that date. But he paid only Rs.3,500 under the daily payment system, and then defaulted.

After Subbiah Ayyar's death, one Parmeswara Ayyar, a relation of Subbiah Ayyar, was appointed the sole administrator of his estate and was empowered to recover all the dues of Subbiah Ayyar in order to pay his creditors and ensure the balance for his widow and children. Parmeswara Ayyar filed O.S. No. 131 of 1950 against Sri Balasaraswathi Ltd., the first defendant, and Sadagopal the second defendant, adding later on Seethalakshmi Ammal also, the wife of Sadagopal, as the third defendant, since the second defendant contended that she had been taken on as a director and shareholder, after Srinivasaga Naidu had left the private limited Company on 10th December, 1947. That suit was for recovering Rs.2,02,074-4-11 from the defendants jointly and severally with subsequent interest and costs. This sum of Rs.2,02,074-4-1 consisted of the principal amount of Rs.1,76,989-14-11, acknowledged by the second defendant as the managing director of the first defendant Company, as the principal amount due from the Company and from him on 18th June, 1950, in Exhibit A-7, and subsequent interest thereon, deducting therefrom the Rs.3,500 paid under the daily payment system.[85]

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85. The Company which consisted only of two shareholders, namely, Sadagopal and his wife, Seethalakshmi, filed through its new managing director, Seethalakshmi, O.S. No. 101 of 1951, against Parmeswara Ayyar, on 19th July,

The trial Court found that the borrowing was valid and therefore binding on the Company, except to the extent of a sum of Rs. 5,465, advanced by Subbiah Ayyar for payment in respect of the dues of Kalakad Toddy shop, run by these brothers, and a sum of Rs. 7,547-15-0 advanced to the second defendant for payment in respect of his own life assurance, as these payments were not for purposes of the first defendant Company. The trial Court, therefore, granted the plaintiff a decree of Rs. 1,94,407-5-11 with interest thereon at six per cent. per annum from 19th December, 1950, the date of plaint, as against the second defendant, Sadagopal; and ordered the first defendant

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85. contd......
1951, adding Sadagopal and Srinivasaga Naidu, the two brothers, as defendants 2 and 3, alleging that Sabbiah Ayyar had failed to show in his accounts enormous sums paid by the Company to him towards the loans contracted by it, and praying for directing Parmeswara Aiyar to render a true and correct account of the dealings between the plaintiff and Subbiah Ayyar and his estate from 14th December, 1945, to the date of suit, and to appoint a commissioner to scrutinise the accounts and to pass a decree for such amount as might be found payable to the plaintiff-Company by Subbiah Ayyar's estate in the hands of the first defendant and for costs. It was alleged that, according to the accounts of the Company, which were of course not produced, a sum of Rs. 2,41,190 was due to the Company from Subbiah Ayyar. There was an allegation that daily remittances aggregating to Rs. 1,60,125 had not been credited in Subbiah Ayyar's accounts towards the debts due by the Company, and that interest amounting to Rs. 30,578-8-7 on the loans advanced to Sadagopal and Srinivasaga Naidu in their personal capacity, and not for purposes of the Company, had been debited against the Company. See ibid., at pp. 302-303.

Company to pay the plaintiff, out of the aforesaid sum of Rs. 1,94,407-5-11, Rs. 1,76,708-5-11 with interest thereon at 6 per cent. per annum from 19th December, 1950, the date of plaint, till realisation.[86]

Against this decision of the trial Court, the first defendant Company filed A.S. No. 340 of 1952, contesting the decree against it as unjustified and incorrect and praying to set it aside and to dismiss the suit as against the Company. The second defendant, Sadagopal, filed A.S. No. 357 of 1952, contending that the lower Court went wrong in finding that he was personally liable for the debts he had contracted on behalf of the first defendant Company, and contending further that even the amount of the decree against the Company was not correct.

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86. See *ibid.*, at p. 305. In the suit filed by the Company, details of which are given in note 85, the trial Court found that the deceased Subbiah Ayyar was not accountable in law to the plaintiff Company, and that the only thing that the Court could do was to hold that the sum of Rs.5,465 advanced in respect of the Kalakad Toddy shop dues, and of Rs. 7,547-15-0, advanced in respect of the insurance payment, with subsequent interest thereon at 12 per cent. per annum would not bind the plaintiff-Company as already held in the other suit. The trial Court held that the remaining amounts advanced by Subbiah Ayyar would bind the plaintiff Company and would make it liable for the decree passed against it in the other suit. The trial Court, therefore, passed a decree on those lines in O.S. No. 101 of 1951, and dismissed the suit in all other respects.

The plaintiff-Company, by managing director, Seethalakshmi, filed A.S. No. 341 of 1952 against that decree. See *ibid.*, at p. 306.

On behalf of the appellant Company, it was contended before their Lordships, Rajamannar, C.J., and Panchpakesa Ayyar, J., that the trial Court went wrong in holding that the two brothers who were shareholders and directors of the Company, had power to contract loans on behalf of the Company, as the memorandum and articles of association did not give them specifically the right to borrow money on behalf of the Company. Their Lordships rejected this contention, holding that the memorandum and articles of association did not say that the directors should not borrow at all on behalf of the Company. No specific power to borrow was, in the circumstances, necessary. The directors could borrow on behalf of the Company upto the issued share capital of Rs. 99,000, as contemplated in Article 73 in Table A of Schedule 1 of the Companies Act, and even above that amount with the assent of the shareholders.[87]

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87. See ibid., at p. 307. Article 1 of the Articles of Association of the Company said that the regulations in Table A of the First Schedule of the Indian Companies Act would be applicable to this Company, so far as they related to a private company and in so far as they were not excluded or modified by the articles of the Company. Article 73 of Table A of Schedule 1 of the Indian Companies Act, 1913 was as follows: "The amount for the time being remaining undischarged of moneys borrowed or raised by the directors for the purposes of the company (otherwise than by the issue of share capital) shall not at any time exceed the issued share capital of the company without the sanction of the company in general meeting".

It was next contended that, even so, the plaintiff's suit must fail regarding the excess over Rs. 99,000, because there was no resolution by the shareholders authorising the borrowing of any loans above that amount. Counsel for the Company pointed out that there was not even a meeting of the shareholders for considering any such contracting of loan above Rs. 99,000, much less a resolution allowing the contracting of a debt above this amount. Counsel for Parmeswara Ayyar, the administrator of Subbiah Ayyar's estate, urged that it was settled law that the acquiescence of all the shareholders in such excess loans contracted by the directors *ultra vires* their powers, but not *ultra vires* the powers of the company, would be sufficient to validate such excess debts. He relied on Halsbury's *Laws of England*[88] and *Parker and Cooper Ltd.* v. *Reading*.[89] Agreeing with this argument, their Lordships observed:

> "In the present case, the Balasaraswathi Company consisted only of two shareholders, *viz.*, the two brothers, Sadagopal and Srinivasaga, at the time it borrowed the moneys from Subbiah Ayyar for the Company. Sadagopal was the managing

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88. To be exact, on para.603 of Volume 6 (3rd ed. 1954), given at p. 299, which runs as follows: "All persons dealing with the company are bound to know its constitution, so that it will not be liable under any contract which is *ultra vires* the directors; but any act of the directors which is not *ultra vires* the company, may be ratified by the company in general meeting, or at an informal meeting of all the shareholders, or by the acquiescence of all the shareholders without a meeting".

89. (1926) 1 Ch. 975, discussed in detail *supra*.

> director and Srinivasaga was a director and a shareholder. By contracting the debts jointly from Subbiah Ayyar for the company and by acknowledging them, they certainly acquiesced in the loans so far as they were _intra vires_ of the company, though they were _ultra vires_ of the directors by exceeding the issued share capital of Rs. 99,000. That they consulted one another is obvious, or will be conclusively presumed from the fact of their jointly contracting the debts and signing in token thereof. The observations of Lord Davey in _Salomon_ v. _Salomon_(90) will apply to this case also, and there will be an inevitable inference from the circumstances of the case, that every member of the company assented, and that, therefore, the debt will be binding on the company to the extent it was _intra vires_ of the company. It was competent of the shareholders to waive all formalities as regard notice, meetings, etc." (91)

Counsel for the Company argued that a joint stock company was a distinct entity, and that, therefore, this Company should have given its assent to exceeding the limit of Rs. 99,000 by a resolution. He contended that the fact that all the shareholders of the Company had joined in contracting the loans could not give rise to the presumptions that they had consulted each other and had agreed to that course of action after waiving the requirements of a formal meeting and of a formal resolution; and therefore it could not save the claim of the plaintiff for the excess over Rs. 99,000.

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90. (1897) A.C. 22.

91. See (1956) 26 Comp. Cas. 298, at p. 308.

Rejecting this argument, their Lordships expressed the opinion:

> "We fail to see any point in setting up the company as a metaphysical entity apart from all the shareholders. The object of article 73 in Table A of Schedule 1 of the Companies Act is to ensure the interest of shareholders, and not to ensure compliance with any such metaphysical requirements". (92)

It was next contented on behalf of the Company that Seethalakshmi, the new managing director of the Company, had not joined in the loans contracted for the Company or in acknowledging their liability, and that she was also a shareholder, and so the ruling in Parker and Cooper Ltd. v. Reading[93] would not apply, as one of the shareholders had not joined in any way, with or without a meeting, and had not signed anywhere.[94]

Dismissing this contention, their Lordships observed:

> "This contention too has no value, as we are satisfied that Sithalakshmi is only a puppet and a benamidar of her husband Sadagopal

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92. Ibid., at p. 309. Their Lordships added: "Besides, as the lower Court itself has pointed out, the excess over Rs. 99,000 will be binding on the company on two other principles, viz., that the loans were advanced by Subbiah Ayyar, a stranger to the company, who was entitled to assume that the internal management of the company was being done regularly by its directors and shareholders and, secondly, because the amounts borrowed for the company by its only two shareholders were received by the company and utilised by it for its own benefit for purposes intra vires of the company like buying buses, tyres, etc. See the rulings in T.R. Pratt Ltd. v. M.T. Ltd., (1936) 6 Comp. Cas. 90".— See ibid.

93. (1926) 1 Ch. 975, discussed in detail supra.

94. See (1956) 26 Comp. Cas. 298, at p. 311.

> and has been brought in the eleventh hour simply to have the minimum number of two shareholders, if not also to defeat and defraud the plaintiff's claim on the company". (95)

Their Lordships held that the amounts decreed by the lower Court against the Company[96] were correct and did not require to be interfered with in the least.

Thus this case decided that all the shareholders assenting, though not at a meeting, to a transaction *intra vires* the Company, was a valid ratification of the *ultra vires* acts of the directors. It may be stated here that this decision represents a correct approach if substance is not allowed to be sacrificed for the sake of form. To insist, in a case like the present one, on a resolution by the general meeting of the company ratifying the excess borrowing by the directors, would amount to subordinating intention of the law to the facade of formalities.

And while an *ultra vires* act of the managing director was held to be ratified, resolution of a meeting was not even mentioned, much less made a necessary condition, in *Abdul Rahman Khan* v. *Mufassal Bank Ltd., Gorakhpur*.[97] This

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95. See *ibid*.

96. Their Lordships further held that the balance decreed against Sadagopal personally was also correct as it was admittedly borrowed by him. See *ibid*., at pp.311-312.

97. A.I.R. 1926 All. 497, decided by the Allahabad High Court on 24th March, 1926.

appeal arose out of a suit brought by the plaintiff-respondent for the recovery of money due on a mortgage effected by Mst. Ulfat Bibi and Abdul Rahman Khan in favour of the Kayastha Trading and Banking Corporation Limited, Gorakhpur, on the 6th of March 1908. The managing director of the Corporation was one B. Ram Gharib Lal who, on the 14th of March 1919, transferred for consideration the mortgagee rights held by the Corporation to Mazhar Hussain Khan. Mazhar Husain Khan subsequently transferred the same for consideration to the plaintiff.

The main question for consideration in this case was whether B. Ram Gharib Lal, the managing director of the Corporation, had the authority[98] to transfer the said mortgage-bond to Mazhar Hussain, and was the plaintiff, as a transferee from Mazhar Hussain, entitled to sue for the recovery of the mortgage money.

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98. The Articles of Association of the Corporation provided that there would be a manager of the Corporation, whose duty would be to conduct the whole business of the Corporation and to perform all such things and services as might be necessary to carry on the said Corporation or its branches and such as were usually performed by the manager of a banking company. B. Ram Gharib Lal was admittedly appointed by the Corporation as its manager or managing director and a general power of attorney was executed by the Corporation in his favour authorising him to make transfers or to execute a deed of conveyance in respect of any transaction sanctioned by the Board. The transfer of the mortgage-bond in the present case was without any sanction of the Board. See *ibid.*, at p. 498.

It was admitted that after the institution of the present suit, to which the Corporation was made a party as a pro forma defendant, a suit was filed by the Corporation itself for the recovery of the money due on the mortgage. But by virtue of a compromise subsequently entered into between the Corporation and the present plaintiff, that suit was withdrawn on the 20th of August 1921. Before that the name of the Corporation had already been removed from the present suit. The Corporation made no objection thereafter to the present suit.

On these fact, their Lordships, Kanhaiya Lal and Ashworth, JJ. held that there was sufficient evidence on which to find that the Kayastha Trading and Banking Corporation Limited had agreed not to sue on the bond itself and to allow the Mufassal Bank to sue on it. This, their Lordships thought, must mean that the Corporation recognised the transfer in favour of Mazhar Hussain, which, in other words, meant ratification[99] by the Corporation of the ultra vires act of its manager.

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99. See ibid., at p. 499, col. 1 and p. 500, col. 1. Both the learned Judges concurred on the point of ratification, though they differed otherwise. Of course, both of them were for dismissal of the appeal. Each of the learned Judges gave one more reason for his decision, besides their common reason of ratification. Whereas the other reason given by Kanhaiya Lal, J., was the applicability to this case of the rule in Royal British Bank v. Turquand, fully discussed in the last chapter, that given by Ashworth, J., was a procedural ground.

Thus the appeal of the mortgagors was dismissed. This case represents a very good example of ratification by conduct. In the last Chapter also, we have seen two more examples of ratification by conduct, though it was not ratification but the rule in Royal British Bank v. Turquand, which was the dominant reason for decision in those cases.[100] Therefore these cases were discussed in the last Chapter.

LIMITATIONS OF THE DOCTRINE OF RATIFICATION

But ratification which, as has been seen, is capable of curing defects of excess of authority by the managerial personnel, becomes powerless when the act concerned is illegal or invalid or fraudulent. These are in addition to the obvious limitation that an act ultra vires the Company cannot be ratified.[101] In all these cases, ratification cannot make the acts concerned binding on the respective companies.

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100. These cases are: (1) Ram Baran Singh v. Mufassil Bank Ltd., A.I.R. 1925 All. 206 (2); and (2) Prabodh Chandra Mitra v. Road Oils (India) Ltd. and others, A.I.R. 1930 Cal. 782.

In the last Chapter, in the discussion of the first case, see particularly para 2 of note 31. In the discussion of the second case, see particularly the last sentence of note 35.

101. See introduction to this Part.

Thus in T.S. Pl. S. Thinnappa Chettiar v. Official Liquidator, Oriental Investment Trust Ltd.,[102] the Madras High Court held that gambling in differences on the stock exchange was not a legitimate business for an investment trust company. Contracts of such a nature, certainly, did not fall within the transactions contemplated by the memorandum of association and were unenforceable even under the general law. Their Lordships further held that the approval of the balance-sheet, mentioning these transactions, by the company in general meeting could not alter the position inasmuch as there could be no ratification of an illegal contract so far as the company was concerned.

Further, the High Court of Bombay held in East and West Insurance Company Limited v. Mrs. Kamla Jayantilal Mehta[103] that: "It is difficult to understand how, if the resolution making the call was invalid, it could be subsequently rendered valid by anything that the directors might do on September 12, 1949. The basis of the call and the basis of the liability of the defendant is (sic) the two resolutions on March 3 and June 22, 1948. If these resolutions

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102. (1944) 14 Comp. Cas. 207, decided on Feb. 10, 1944, in appeal by a bench consisting of Leach, C.J., and Lakshmana Rao, J., of the Madras High Court. Judgment of the bench was delivered by Leach, C.J.

103. (1956) 26 Comp. Cas. 313, decided in appeal on February 13, 1956 by a bench consisting of Chagla, C.J., and Dixit J., of the Bombay High Court. Judgment of this bench was delivered by Chagla, C.J. The defendant,

are invalid, they cannot be rendered valid by the resolution of September 12, 1949. This is not a case where a valid resolution has been passed by some one lacking the necessary authority. In that case the persons with the requisite authority may adopt the resolution validly passed and thereby ratify it. But where the objection to the resolution is not the want of authority but illegality in the very making of it, in the very passing of it, then _it is impossible to accept Mr. Engineer's contention that the doctrine of ratification can validate a resolution which when it was passed was invalid_".[104]

In _Dr. D.R. Banaji_ v. _Manilal T. Patel_,[105] the directors of a private company, who were the only shareholders, had fraudulently credited in the cash-book of the company, in advance of the date of receipt, amounts received for goods sold and had made fictitious entries regarding

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103. contd......
who was the respondent in this appeal, was at all material times a shareholder of the plaintiff company who were the appellants. The plaintiff company filed a suit to recover from the defendant a sum of Rs.4,835, being the amount due in respect of calls made by the company and interest thereon. The contention of the defendant was that the call was not validly made. That contention was accepted by the trial court which dismissed the plaintiff's suit. The plaintiffs then filed this appeal.

104. _Ibid._, at p. 331. Emphasis added. The appeal was dismissed.

105. (1957) 27 Comp. Cas. 43, decided on February 27, 1956, by Desai, J., of the Bombay High Court.

purchase and consumption of stores to the extent of Rs. 2,61,700. The liquidator took out misfeasance summons against one of them who had been in management of the affairs of the company.

It was argued on behalf of the respondent that the company was a two-men show and that it must be deemed to have ratified the fraud of the self-same two directors who were the only shareholders of the company. It was said that this was a private limited company and the respondent and Finegold were businessmen who must be regarded as partners and the company must be treated as a partnership firm and, therefore, the question of the liability of these two persons cannot now be agitated by the liquidator.

Rejecting this contention, his Lordship observed: "The argument was somewhat metaphysical but metaphysics and businessmen seldom meet. <u>Fraud practised on the company even by directors who are themselves the sole shareholders cannot, in my judgment, be expurgated by recourse to any such fanciful ratification</u>. The contention fails and must be negatived".[106]

<u>CONCLUSIONS</u>

In the preceding pages we have seen how ratification by the company cures the defect of excess of authority by

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106. <u>Ibid.</u>, at p. 53. Emphasis added.

the managerial personnel and how it thereby ensures that those acts of the managerial personnel bind the company. We have also seen that this result follows only from a valid ratification and all acts are not ratifiable. Further it is also clear that ratification, in order to be valid, must be effected by the shareholders with full knowledge of the facts and the irregularity involved in those facts. If all shareholders in fact assent to a certain act, then a general meeting is not necessary to ratify that act. There is some difficulty, however, about saying whether for ratifying an act in contravention of the Articles, a special resolution is necessary or an ordinary resolution merely will be sufficient. As has been seen the English law is in favour of the latter view,[107] while in India the former view has been upheld.[108] On principle and also as a matter of policy, the Indian view appears to be the better of the two. On principle, because an action in contravention of the Articles ought, in order to be validated, to have the concurrence of the same majority which can change the Articles. As a matter of policy, because the requirement of a special resolution will have some little sobering effect on the managerial personnel inasmuch as it will dissuade them from acting in contravention of the Articles very frequently.

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107. See Grant v. United Kingdom Switchback Railways Company, (1888) 40 Ch. D. 135, C.A., discussed supra.

108. See M.K. Srinivasan v. W.S. Subrahmanya Ayyar, (1932) 2 Comp. Cas. 147, discussed supra.

CHAPTER 3

EXCESS OF AUTHORITY NOT COMING UNDER THE PRECEDING TWO CHAPTERS

In the first Chapter of this Part, we have seen how excess of authority by managerial personnel is cured if the circumstances bring the case within the purview of the rule in *Royal British Bank* v. *Turquand*.[1] In the second Chapter, we have seen how ratification, properly effected, could cure the defect of excess of authority. The aim of this chapter is to examine the fate of an excess of authority which does not fall under either of the preceding two chapters.

Borrowings by the managerial personnel in excess of their authority, not cured under the preceding two chapters, are also sometimes held binding on the companies provided that certain conditions hold good. These conditions are that the money borrowed in excess of authority of the managerial personnel should go to the coffers of the company and be utilised for its purposes, and that in any case this borrowing should not be *ultra vires* the company. The chief supporter and exponent of this view is a case which at the first appellate

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1. 5 El. & Bl. 248; 6 El. & Bl. 327.

stage appeared as T.R. Pratt (Bombay) Ltd. v. E.D. Sassoon & Co., Ltd.[2]

This matter arose in the liquidation of T.R. Pratt (Bombay) Ltd. The claims in question were made by E.D. Sassoon and Co. Ltd. and M.T. Ltd. For the sake of convenience, we will refer to the three companies as Pratts, Sassoons, and M.T.s. Pratts was incorporated in the year 1919 with a capital of Rs. five lakhs, divided into preference and ordinary shares. The memorandum of association of this company contained a power to borrow and to give security for the money borrowed, but there was no power to give security for a debt of third parties. Originally, articles of association were prepared, but by some error they were not registered; therefore the company was regulated by Table A of the First Schedule to the Indian Companies Act, 1913. Article 73 of Table A limited the directors' power of borrowing by providing that the amount for the time being remaining undischarged of moneys borrowed by the directors should not exceed the issued capital of the company without the sanction of the company in general meeting.[3]

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2. (1936) 6 Comp. Cas. 90. Judgment of trial court is given at pp. 94 to 122 of this Report. This case in second appeal before the Privy Council appeared as T.R. Pratt (Bombay) Ltd. v. M.T. Ltd., A.I.R. 1938 P.C. 159.

3. Article 73 of Table A ran as follows:
"The amount for the time being remaining undischarged of moneys borrowed or raised by the directors for the purposes of the company (otherwise than by the issue of share capital) shall not at any time exceed the issued share capital of the company without the sanction of the company in general meeting".

M.T.s was incorporated in 1920. It was formed by Messrs. Mehta & Co., who were the managing agents of Pratts, and by persons interested in Sassoons. The principal object of this company was to finance Pratts, the view being that Pratts' capital was insufficient for the business which they were capable of doing. M.T.s acquired practically the whole of the ordinary share capital of Pratts, but the preference shares were held by outside parties. At the date of liquidation of Pratts, which was June 22, 1932, a sum of approximately Rs. 4,92,000 was due from Pratts to M.T.s. Sassoons used to finance M.T.s, and in the year 1926 to 1928 there was a sum of approximately Rs.9,00,000 due by M.T.s to Sassoons.

It appeared that in the year 1926 Sassoons commenced to press M.T.s to give security for the debt. M.T.s had an immovable property known as the Collins Building, which was a part of the building in which Pratts carried on business, and Pratts had two immovable properties. Sassoons wanted to get a mortgage upon all those properties, both of M.T.s and Pratts, as security for the money due to it. Originally it was proposed that there should be two documents - one between M.T.s and Pratts and the other between M.T.s and Sassoons. But in order to avoid expenses it was arranged to have only one document. Accordingly, on February 23, 1928, resolutions were passed by the boards, both of Pratts and of M.T.s, for

execution by the respective companies of a security deed in favour of Sassoons, and on February 28, 1928 the security deed in question was executed.

That document was made between M.T.s (thereinafter called the mortgagor of the first part), Pratts (thereinafter called the surety of the second part) and Sassoons (thereinafter called the mortgagee of the third part). It recited the title to the properties which were to be mortgaged, and then it recited that Pratts required money for the purpose of their business and requested M.T.s to lend them money, and that M.T.s requested Sassoons to lend them Rs. 9 lakhs, in order to enable them to lend money to Pratts. Then it recited that Sassoons had already paid to M.T.s Rs. 9 lakhs, out of which M.T.s had paid to Pratts Rs. 4½ lakhs. This document thereafter recited deposits of title-deeds of the immovable properties, both of M.T.s and Pratts, with Sassoons, and then the witnessing part stated that Pratts x had already deposited with Sassoons the title-deeds of the properties therein mentioned, with intent that the properties might be equitably charged with the repayment to Sassoons of the sum of Rs. 4½ lakhs out of the sum of Rs. 9 lakhs advanced by Sassoons to M.T.s with interest. Then M.T.s and Pratts jointly and severally covenanted with Sassoons to pay the said sum of Rs.4½ lakhs.

The claims of M.T.s and Sassoons were admittedly not additional but alternative claims. Kania, J., at the

trial, first took the claim of M.T.s for examination, and discussion of this claim alone is relevant for our purposes in this chapter.

The liquidator of Pratts relied on the observations in Irvine v. Union Bank of Australia[4] to the effect that Royal British Bank v. Turquand[5] did not apply. Kania, J., thought that Articles 73 of Table A was similar in terms to the relevant article in Irvine v. Union Bank of Australia and supported the contention that when there was a prohibition against borrowing contained in the article, it was not a case of internal management.[6] His Lordship was of the opinion that under the circumstances, it being common ground that no resolution at any general meeting of the company was passed, the directors were not authorised to borrow money beyond the amount of the issued share capital of the company.[7]

Relying on Irvine v. Union Bank of Australia, the liquidator of Pratts further contended that if the borrowing was ultra vires the directors, no debt binding on the company was created except when the company ratified it. It was urged that there was no valid ratification of the borrowing because the attention of the shareholders was never expressly

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4. (1878) 3 I.L.R. Cal. 280 P.C. This case has been discussed in detail in the last chapter; see text to note 11.

5. 5 El. & Bl. 248; 6 El. & Bl. 327.

6. See (1936) 6 Comp. Cas. 90, at p. 98.

7. See ibid., at pp. 98-99.

drawn to the fact that the directors, having no authority to borrow in excess, had so borrowed and that at the meeting they would be called upon to confirm that unauthorised borrowing of the directors.[8]

On behalf of M.T.s, it was urged that in any event the Company was liable because, however unauthorised the directors' borrowings might be, the shareholders of the Company were aware of these and had ratified the same by their acquiescence. In this connection, M.T.s relied on the balance-sheets prepared by the directors and passed by the share-holders, year after year, at their annual general meetings from 1921 onwards. These balance-sheets clearly showed the amounts due by the Company to M.T.s from year to year, and it was not disputed that those balance-sheets were duly passed by the shareholders.[9]

Kania, J., did not agree with this contention of M.T.s. In order to establish a case of ratification, his Lordship considered it to be essential, that the party ratifying should be conscious of an act beyond the authority of the agent having been done, and should further, by an overt act, agree to be bound by it or by acquiescence in the situation arising thereafter allow the business to continue.[10]

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8. See *ibid.*, at p. 99.
9. See *ibid.*, at pp. 104-108.
10. See *ibid.*, at p. 106.

In either event, it appeared to his Lordship, that consciousness of the act done by the agent without authority must be proved, and, secondly, it should be proved that, after notice of such unauthorised act, the principal adopted the transaction.[11]

Having regard to all these considerations, his Lordship concluded that the contention of M.T.s, that the Company by adopting the balance-sheets had ratified the borrowings, could not be accepted.[12]

The liquidator further relied on the decision in <u>Sinclair</u> v. <u>Brougham</u>,[13] in which it was held that if a company was not authorised to borrow any money and if money in fact was borrowed, no claim could be maintained by the lender against the company on the footing either of debt or of money had and received. On behalf of M.T.s, on the other hand, it was contended that this argument of the liquidator was fallacious and was based on a misconception of the situation, as the principles laid down and the opinions pronounced in <u>Sinclair</u> v. <u>Brougham</u> were all based on the central fact that the borrowing by the society itself was <u>ultra vires</u>, whereas in the present case the borrowing was <u>intra vires</u> the Company though <u>ultra vires</u> the directors.

Kania, J., thought that the contention of the liquidator in this connection was wrong as according to the

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11. See <u>ibid</u>.
12. See <u>ibid</u>., at p. 105.
13. (1914) A.C. 398.

general principles of law when an agent borrowed money for a principal, without the authority of the principal, and if the principal took the benefit of the money so borrowed or when the money so borrowed went into the coffers of the principal, the law implied a promise to repay. To his Lordship, there appeared to be nothing in law which made this principle inapplicable to the case of a joint stock company when the borrowing power of the company itself was unlimited.[14]

The position, in his Lordship's opinion, would be that the principal, the Company in this case, through its agents, the directors or the managing agents, had borrowed money which the principal had not authorised the agents to borrow. However, the money having been borrowed and used for the benefit of the principal, either in paying its debts or for its legitimate business, his Lordship expressed the view, the Company could not repudiate its liability to repay on the ground that the agents had no authority from the Company to borrow. In his Lordship's opinion, when these facts were established, a claim on the footing of money had and received would be maintainable.[15]

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14. See (1936) 6 Comp. Cas. 90, at p. 100.
15. See *ibid.* His Lordship distinguished the present problem from the one involved in *Sinclair* v. *Brougham* on the ground that in that case the borrowing was *ultra vires* the principal itself, whereas in the present case the borrowing was *intra vires* the principal though *ultra vires* the directors.

His Lordship observed that he was supported in holding this view by the decision in Reid v. Rigby & Co.,[16] Bannatyne v. MacIver,[17] Troup's case[18] and British and American Telegraph Co. v. Albion Bank.[19]

But it was argued on behalf of the liquidator that Irvine v. Union Bank of Australia[20] decided to the contrary. In reply, his Lordship observed that in that case, the O.R. Company, which was a party to the original suit, had not appeared before the Privy Council at all and the question of directing an inquiry as to what portion was bona fide used for the benefit of the company was not considered, nor was the question of a tracing order discussed. His Lordship therefore found himself unable to consider that decision as over-riding the general principle of law under which a principal was liable for what he actually received, when his own powers of borrowing or receiving were not limited.[21]

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16. (1894) 2 Q.B. 40.
17. (1906) 1 K.B. 103.
18. (1860) 29 Beav. 353.
19. (1872) 7 Ex. 119. His Lordship noted with satisfaction that in Halsbury's Laws of England, Vol. 5, at p. 314 (2nd ed.), this case was relied upon for the following proposition: "Apart from ratification, the company will be answerable for any property which has come into its possession through the unauthorised acts of the directors". See (1936) 6 Comp. Cas. 90, at p. 102.
20. (1878) 3 I.L.R. Cal. 280 P.C. See Note 4 supra.
21. See (1936) 6 Comp. Cas. 90, at p. 104.

His Lordship concluded:

> "In the present case the balance sheets and the accounts put in show that the amount borrowed by the company from M.T. Ltd. was utilised for the business of company and the results of the dealings were submitted every year to the share-holders. It is not suggested on behalf of the liquidator that any business done by his company was ultra vires the company. Therefore the money received by the company from M.T. Ltd., through the directors and managing agents was bona fide utilised for the business of the company and the company has received the benefit thereof. I, therefore, hold that for the reasons mentioned above M.T. Ltd. are entitled to claim from the company the balance of the amount advanced by them". (22)

And this conclusion of Kania, J., was upheld in appeal by a division bench of the Bombay High Court and in second appeal by the Privy Council.

Beaumont, C.J., one of the two members of the division bench, in this connection observed:

> "I agree also with the argument of Mr. Setalvad on behalf of M.T.s that in a case where the borrowing is ultra vires the directors, and not ultra vires the company, the money could be recovered in an action for money had and received. As pointed out by the Lord Chancellor in Sinclair v. Brougham where the borrowing was ultra vires the company, no action for money had and received lies in such a case, because the action is based on a fiction of a promise to pay, and you cannot have a fictional promise to pay where the promisor is not competent to give an actual promise. But that reasoning does not apply where the borrowing is only ultra vires the directors, so that the company can ratify the borrowing and give a valid promise to pay". (23)

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22. See ibid.
23. See ibid., at p. 133.

And their Lordships of the Privy Council expressed themselves thus:

> "The right of M.T. Limited to prove as unsecured creditors for the balance outstanding at the date of the winding-up order was affirmed by both Courts in India . . . . Assuming however that the directors from 1921 to 1928 exceeded their authority in so far as the advances obtained from M.T. Ltd. exceeded five lacs of rupees, the loans were not ultra vires of the company, and there are concurrent findings of the Indian Courts that the money was received by the company and applied for its purposes. In these circumstances it is plain that the Official Liquidator cannot reduce the balance outstanding at the date of liquidation by disputing x the liability of Pratts to repay the whole sums advanced". (24)

The view that money borrowed by the managerial personnel in excess of their authority under circumstances such as these, could be recovered from their companies, subsequently found favour with the High Courts of Madras and Allahabad also.

In Sri Balasaraswathi Ltd. v. Parmesvara Aiyar,[25] the High Court of Madras held that the excess over Rs.99,000 would be binding on the company, also on the principle that "because the amounts borrowed for the company by its only two

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24. See T.R. Pratt Ltd. v. M.T. Ltd., A.I.R. 1928 P.C. 159, at p. 164, col. 1. The Privy Council consisted of Lord Wright, Lord Romer, Sir Lancelot Sanderson, Sir Shadi Lal and Sir George Rankin. Judgment of the Council was delivered by Sir George Rankin.

25. (1956) 26 Comp. Cas. 298. This case has been discussed in detail in the last Chapter (see text to note 83), because the decision of this case is predominantly based on the doctrine of ratification.

shareholders were received by the company and utilised by it for its own benefit for purposes intra vires of the company like buying buses, tyres, etc.".[26]

In L.R. Cotton Mills Co. Ltd. v. J.K. Jute Mills Co. Ltd.,[27] the High Court of Allahabad, after stating with approval the observations, as given above in this Chapter, of Kania, J., in Pratts case,[28] observed: "In the present case, therefore, even supposing for a moment that the action of the directors was unauthorised, the defendant company would be liable because it is admitted by the defendant company that it did come into possession of the money advanced by the plaintiff and the said money had gone into its coffers".[29]

CONCLUSIONS

Thus we have seen that a borrowing by the managerial personnel in excess of their authority, even though this excess does not fall within the purview of the preceding two Chapters, binds their company provided the money thus borrowed went to the coffers of the company and was utilised for its purposes, and provided that the borrowing was not

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26. See ibid., at p. 309.
27. (1957) 27 Comp. Cas. 660. This case has been discussed in detail in Chapter 1 (see text to note 52) of this Part as the decision of this case is predominantly based on the rule in Royal British Bank v. Turquand.
28. (1936) 6 Comp. Cas. 90.
29. See (1957) 27 Comp. Cas. 660, at p. 672.

ultra vires the company.

The question which next arises is what is the remedy of the third party if the managerial personnel of a company entered into a transaction with him in excess of their authority which excess is incapable of being cured under either of the proceeding two Chapters and also under the present Chapter. The third party, it is believed, may sue the managerial personnel concerned in damages for breach of express or implied warranty of authority. No Indian authority is at hand in this regard but there are two English authorities which have been discussed in Chapter 8 of Part I of this thesis. They are *Cherry and M'Dougall v. The Colonial Bank of Australasia*,[30] and *Chapleo v. Brunswick Building Society*.[31] They have been discussed there along with three other cases which are authority for the proposition that in the case of acts *ultra vires* the company also, an aggrieved third party can sue the directors for breach of implied warranty of authority. And since in respect of directors' liability it appears to make no difference whether the contract is *ultra vires* the company or merely *ultra vires* the directors,[32] all these five cases have been discussed together in that Chapter. But we have seen there, it may be recalled, that the actual availability

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30. (1869) L.R. 3 P.C. 24.
31. (1881) 6 Q.B.D. 696, C.A.
32. See Gower, *The Principles of Modern Company Law*, at p. 90, note 72 (2nd ed. 1957).

of this remedy is very uncertain as it is available only in cases of misrepresentations of fact and not of law and because courts have not followed a consistent policy in deciding what are misrepresentations of fact and what are misrepresentations of law.

PART III

ABUSE OF AUTHORITY BY A MAJORITY OF SHAREHOLDERS

Majority here includes every sort of majority, a simple majority as well as any special majority. Before discussing the abuse of a majority's authority, we must understand the extent of that authority.

There are two vital organs of any company, namely, the general meeting and the board of directors.[1] All[2] the powers of a company are exercised by either of these two

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1. According to Professor L.C.B. Gower, the directors have ceased to be mere agents of their company. He says: "Both they and the members in general meeting are primary organs of the company between whom the company's powers are divided . . . . The old idea that the general meeting alone is the company's primary organ and the directors merely the company's agents or servants, at all times subservient to the general meeting, seems no longer to be the law as it is certainly not the fact". See his book, The Principles of Modern Company Law, at p. 127 (2nd ed. 1957).

2. In companies having managing directors, the latter also exercise a part of the company's authority but they do it as delegates of the board of directors.

   Professor Gower considers it possible that the directors may effectively divest themselves of part of their own powers in favour of the managing director in which case the managing director also will be a primary organ, increasing the number of primary organs to three. See Gower, op. cit., at p. 131.

organs. In both these organs the majority prevails. At a meeting of the board of directors, questions are decided by the vote of a majority of the directors present. If the choice of directors is by ordinary election, a majority of shareholders can elect all the directors. Even if it is by proportional representation, a majority of shareholders can elect at least a majority of the directors. Thus a majority of shareholders will be able to carry the board of directors with them. The general meeting also decides all matters by a majority vote. In most cases this is a simple majority; in other cases it is a special majority of 75 per cent. Thus a majority of shareholders able to command 75 per cent. votes can carry the general meeting with it in all matters. So, in practice, a 75 per cent. majority can exercise all[3] the powers of the company, either directly in the general meeting or indirectly through the board or the managing director.

Abuse of authority here, as elsewhere, means improper use of authority. So this Part deals with cases

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3. Even if a company has a managing director occupying the position of a primary organ (see note 2 _supra_), it is still a majority of shareholders who in fact exercise the authority, but of course indirectly. This is so because the appointment of managing director could not be made unless that person is chosen by a majority and, even if once appointed, he will have to go if he has forfeited confidence of the majority.

in which the majority of shareholders exercised their authority for purposes or ends, or in a manner, disapproved by law. Abuse of authority may hit the minority alone or it may hit the company as a whole.[4] It may hit the public interest also. Chapter 1 of this Part deals with abuse of authority which hits the minority alone. While Chapter 2 deals with abuses of the other two varieties.

4. It is true that an abuse which hits the company as a whole will hit the minority also. But this effect will be incidental and indirect, and will result "from the fact that the depredations of the majority will necessarily deplete such assets of the company as are available for distribution to all shareholders either by way of dividend or on winding up". Besides the minority, the creditors of the company will also be affected by this abuse. See B.H. McPherson, "Oppression of Minority Shareholders, Part I: Common Law Relief", 36 Austl. L.J. 404, at p. 405 (1962-63).

CHAPTER 1

ABUSE OF AUTHORITY WHICH OPPRESSES THE MINORITY AND RELIEFS AGAINST IT

Company law started with majority rule but in course of time it became obvious that if the majority were allowed to have all their wishes, unfettered by any other consideration, they could ride rough-shod over the interests of the minority. Company legislation began therefore to put some curbs on the powers of the majority, to safeguard the minority. The courts also, in spite of their preference for not interfering with the internal affairs of a company, came forward to grant relief to the minority against abuse of their authority by the majority.

COURT'S GENERAL ATTITUDE OF NON-INTERFERENCE

The general attitude of courts has always been against interference with the internal affairs[1] of a company

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1. But not every matter that the company may claim belonging to the domain of internal affairs and so beyond the court's jurisdiction will be found to be so. For example, see Bharat Insurance Co. Ltd. v. Kanhaya Lal Gauba, A.I.R. 1935 Lah. 792 and M.R.S. Rathnaveluswami Chettiar v. M.R.S. Manickavelu Chettiar, A.I.R. 1951 Mad. 542.

   In the first case, Dalip Singh and Sale, JJ., while affirming the general principle of non-interference in the internal affairs of a company, held that where the main dispute was over the meaning of a certain clause in the memorandum of association relating to application

acting within its powers.[2] If a power belongs to a majority, the courts would not interfere with the majority's exercise of it. A classical expression of this attitude is the following statement of Mellish, L.J., in McDougall v. Gardiner.[3]

> "In my opinion, if the thing complained of is a thing which in substance the majority of the company are entitled to do, or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having a litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes. Is it not better that the rule should be adhered to that if it is a thing which the majority are the masters of, the majority in substance shall be entitled to have their will followed". (4)

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1. contd.......

   of assets of the company, it was not a matter of mere internal affairs and so did not oust the Court's jurisdiction.

   In the second case, while approving the general rule of non-interference, Raghva Rao, J., held that the suit of a person who had been removed from the office of managing director, for declaration that he, rather than the person who claimed to have been elected in his place, was still the managing director, was not a dispute about internal affairs, and so did not oust the Court's jurisdiction.

2. This is the first of the two principles constituting what is known as the rule in Foss v. Harbottle. See next Chapter.

3. (18[illegible]) 1 Ch. 13.

4. Ibid., at p. 25.

A quarter of a century later, in Burland v. Earle,[5] Lord Davey reiterated the same judicial attitude in the following words:

> "It should be added that no mere informality or irregularity which can be remedied by the majority will entitle the minority to sue, if the act when done regularly would be within the powers of the company and the intention of the majority of the shareholders is clear". (6)

In Indian law also, there is ample evidence of this judicial attitude.

In Parshuram v. Tata Industrial Bank Ltd.,[7] a minority of shareholders filed a suit against the company for a declaration that the proceedings of a general meeting held on May 1, 1923, were improperly conducted and that certain appointments of directors and auditors made at that meeting were invalid. The plaint also prayed for an injunction restraining the company from having its accounts audited by the auditors appointed at that meeting and also for a mandatory injunction to compel the company to hold a fresh meeting. Pratt, J., dismissed the suit, holding that irregularities were not a matter for the court but for a majority within the company to handle and that a court was not to interfere to correct an irregularity or to do that which the majority of the company had the power to do.

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5. (1902) A.C. 83, P.C.
6. Ibid., at pp. 93-94.
7. A.I.R. 1924 Bom. 102.

Explaining the reasons for this attitude, his Lordship observed that "efficious interference by the court in such matters would paralyse the working of all joint stock companies".[8]

In Ghandy v. Pugh,[9] Mookerjee and Rankin, JJ.,[10] dismissed the plaintiff-appellant's appeal as they held this case coming under the principles of law enunciated by Lord Davey in Burland v. Earle[11] to the following effect:

> "It is an elementary principle of the law relating to joint stock companies that the court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so . . . (The minority) cannot complain of acts which are valid if done with the approval of the majority of the shareholders, or are capable of being confirmed by the majority". (12)

For the same reasons, Rangnekar, J., dismissed a minority shareholders' suit in Bhajekar v. Shinkar.[13]

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8. Ibid., at p. 103.
9. A.I.R. 1924 Cal. 598.
10. Ibid., at p. 599.
11. (1902) A.C. 83.
12. Ibid., at p. 93.
13. A.I.R. 1934 Bom. 243. His Lordship thought that the court has no jurisdiction to interfere with the internal management of a company acting within its powers. Even where a minority of shareholders are alleged to have been overborne by the vote of a majority, they cannot complain of acts which are valid if done with the approval of the majority of the shareholders or could be confirmed by the majority. The aggrieved shareholders, instead of coming to the court, must appeal to the company in general meeting.

The same judicial attitude was partly responsible for the dismissal of plaintiff-appellant's appeal by Beaumont, C.J., and Rangnekar, J., in Ram Kumar Potdar v. Sholapur Spinning & Weaving Co. Ltd.[14]

On the same grounds, in Kirpa Ram v. Shrivans Prasad,[15] Kapur, J., refused to interfere and held that the proposed scheme should be allowed to go through and that the Court should not interfere at the instance of a minority shareholder who could not shew any sufficient reason why the Court should deviate from the general rule of non-interference with the wishes of the majority.

But this rule of non-interference, like all general rules, admits of exceptions. Ultra vires acts are one such

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13. contd......
His Lordship further observed that the court was not to interfere for the purpose of forcing companies to conduct their business according to the strictest rules where the irregularity complained of could be set right at any moment. And here, his Lordship held that the irregularity complained of had been set right by the company (which meant the majority) by ratification.

14. A.I.R. 1934 Bom. 427. Chief Justice Beaumont put the matter in the following words, at p. 427: "It is a well-settled principle in company law that the Court does not generally interfere with the internal management of the affairs of a company, and, if the majority of the shareholders consider that a particular contract of employment should be terminated, the Court would not as a rule consider the matter at the instance of a minority of shareholders".

15. A.I.R. 1951 Punj. 79.

exception[16] and acts of majority done in abuse of their authority, are another such exception. It is with the latter exception that we are concerned in this Part.

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16. In the case of *ultra vires* acts, the courts interfere also on the ground that *ultra vires* acts do not fall within the domain of internal affairs of a company. See note 1, *supra*.

A good deal has already been said in Part I of this thesis about acts which are *ultra vires* in the strict sense of this term where it means acts beyond the objects clause. We give below some illustrations of interference by courts at the suit of minority on the ground of acts which are *ultra vires* in a loose sense of this term.

In *M.K. Srinivasan* v. *Watran S. Subramania Ayyar*, A.I.R. 1932 Mad. 100, a Life Assurance Co.'s directorate was required to be composed of two policy-holders' directors, to be elected by the policy-holders, and five shareholders' directors to be elected by the shareholders in their general meeting. Instead of election at the general meeting, the two policy-holders' directors co-opted two of the shareholders as directors and then these four directors co-opted three other shareholders as directors. A minority of shareholders challenged the co-option as *ultra vires* and prayed for an order for poll to elect the shareholders' directors. It was contended that assuming that the co-opted directors had usurped the office of shareholders' directors, still this was a matter capable of confirmation by the company in general meeting. Curgenven and Cornish, JJ., who decided this matter in appeal, rejected this contention, and held that the confirmation of the co-option of directors would be *ultra vires* the general meeting as a violation of the articles which required shareholders' directors to be elected at general meeting, the articles being binding on the general meeting also unless changed by a special resolution. Their Lordships ordered a poll for election of shareholders' directors as the minority wished.

In *Dhakeshwari Cotton Mills Ltd.* v. *Neel Kamal*, (1938) I.L.R. 1 Cal. 90, Nasim Ali and Remfry, JJ., held a suit maintainable which was brought by a minority against the company without taking its permission. The suit was for a declaration that a particular resolution of the company was not binding on it as not having been carried and passed according to law. It

This chapter deals with that abuse which particularly hits the minority and which is therefore sometimes loosely termed as "fraud on the minority". The courts have always attempted to prevent the majority from putting their authority to bind the minority to an improper use. Whenever the courts found at the complaint of the minority that this was being done to the deteriment of the minority, the courts always shewed a willingness to interfere.

COURTS' INTERFERENCE AT THE INSTANCE OF MINORITY

The following are illustrations from Indian Law.

In Gobind Prasad Das v. Akhoy Kumar Dey,[17] at a meeting of the shareholders of a company, a minority of

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16. contd......
was alleged that the resolution was therefore *ultra vires*. The resolution in this case was passed by a majority but not by the statutory majority required for a special resolution. The court struck down this resolution of the majority saying that it was *ultra vires* to purport to pass a special resolution without the requisite majority.

In Ram Kissendas Dhanuka v. Satya Charan Law, A.I.R. 1950 P.C. 81, Lord Greene, delivering the judgment of the Privy Council, observed that where an article of association of a company required, as in the present case, an extraordinary resolution to terminate the appointment of the managing agents, the requirement was intended as a protection to a minority who are not to have the appointment terminated against their will unless a particular majority voted in favour of it. As in this case the company terminated the appointment by an ordinary resolution, his Lordship held that the question here was much more than one merely concerning the internal management of the company and a suit for declaring the resolution as *ultra vires*, was not barred.

17. 10 Cal. W.N. 906 (1905-1906).

shareholders were not allowed by the majority to vote. They sued for a declaration that they were entitled to vote at the meetings of the company. Rampini and Woodroffe, JJ., held that the minority had a cause of action.

In Vadilal Raghavji v. Maneklal Mansukhbhai,[18] the suit was brought by a shareholder on behalf of himself and all the shareholders of the defendant company except the first defendant, his nominees and those under his control. The first defendant was manager of the defendant company and was also a member of the managing agency firm of the company. The charges against him were misappropriation of the company's goods, and personal use of advantages belonging to the company. These charges were broadly termed "fraud". The plaint alleged that the first defendant, his nominees or relations, controlled a majority of shares in the company. The first defendant took a preliminary objection that inasmuch as a majority of the shareholders did not favour the plaintiff's suit, it must be dismissed. The objection prevailed. On appeal, Morten and Fawcett, JJ., reversed, holding that the case should go to trial on the allegations of "fraud".

In Sabapathy Rao v. Sabapathy Press Co. Ltd.,[19] the managing director was able to outvote the minority of the

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18. A.I.R. 1925 Bom. 188.
19. A.I.R. 1925 Mad. 489.

shareholders; and to retain the profits of the business among the members of his family. Moreover, the minority shareholders complained that they did not receive copies of the balance-sheet, and that the auditor's report was not read at the general meeting or attached to the balance-sheet, as required by s.131 [20] of the Companies Act, 1913. Further, the dividends were not paid regularly and the rate of dividend had been steadily diminishing. Spencer, Offg. C.J., and Srinivasa Aiyangar, J., held that these were sufficient grounds to allow a winding-up application presented by the aggrieved minority.

In _Jhajharia Bros. Ltd._ v. _Sholapur Spinning and Weaving Co. Ltd._, [21] a minority of shareholders imputed the motive of capturing control of the company to a proposed increase of share capital. The increase had been sanctioned by a resolution of the majority. These minority shareholders alleged that the directors and the managing agents fraudulently obtained support of the majority in passing the resolution and prayed that the company be restrained from acting on it. The directors were not made parties to the suit.

Ameer Ali, J., observed that in such a case the primary fraud must be clearly indicated and that on the

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20. New ss. 210 and 216 of the Companies Act, 1956.

21. A.I.R. 1941 Cal. 174.

facts he was unable to find that a fraud was committed upon the company of the nature alleged. In his Lordship's opinion, a clear indication of the fraud was the gist of the action, although no doubt a pleading might be so framed as to stress the dominance of the majority and the effectuation of the fraud through that dominance. His Lordship thought that where a decision of the directors was attacked as injurious to the company, the directors must be parties. Where their act has been confirmed and is yet impeached, still those directors must be made parties. His Lordship further observed that in such a suit as this, the plaintiffs must be all the shareholders except those made defendants. For these reasons, the suit was dismissed, but it seems possible that if the suit had been properly framed and the "fraud" clearly indicated and substantiated, the suit could have succeeded.

The preceding four cases show that the Indian courts have been quite willing to help a minority against abuse of authority by a majority. But it is also clear that except in the first case[22] and in the case when the minority obtained a winding-up order,[23] in the remaining two cases relief to the minority could not be substantial. Nor, probably, could it be expected to be substantial, as

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22. Gobind Prasad Das v. Akhoy Kumar Dey, supra.
23. Sabapathy Rao v. Sabapathy Press Co., Ltd., supra

"fraud on the minority" was an expression having no definite meaning;[24] thus leaving both, the right of the minority to seek relief and the power of the court to grant relief; indefinite.

The remedy of a winding-up order also was not, in general, very helpful[25] to the aggrieved minority

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24. "In a suit so brought, the complaint is said to be of a 'fraud on the minority'. If by this it is understood that the minority in a company have some natural right to sue a majority which is oppressing it, if it is suggested that there is any such thing legally as a wrong done by a bigger group to smaller group within the company and, therefore, there is a class of action by a minority qua minority against a majority qua majority, I disagree. There can be no such thing as a legal war of parties". Ameer Ali, J., in Jhajharia Bros., Ltd. v. Sholapur Spinning and Weaving Co. Ltd., A.I.R. 1941 Cal. 174, at p. 178.

    Even in English law, meaning of this expression is not free from difficulties. "It is not easy to state when an act qualifies as fraud on the minority and it would be unprofitable to attempt a definition of that term". See Palmer's Company Law, (20th ed. 1959) at p. 498. Gower, op.cit., says at p. 509: "As we shall see, the next meaning of the expression 'fraud on the minority' is not easy to determine. But at least it is clear that both 'fraud' and 'minority' are used somewhat loosely. There need not be any actual deceit; if there were, those on whom it was practised would have a common law remedy against those who had wilfully deceived them. 'Fraud' here connotes an abuse of power analogous to its meaning in a court of equity to describe a misuse of a fiduciary position".

25. Speaking of the position in English law before 1948 which was equally true of Indian law before 1951, the (Indian) Company Law Committee, popularly known as the Bhabha Committee, in its report submitted in 1952, observed: "the only effective remedy against oppression of which the minority shareholders could avail themselves, if they succeeded in proving their case, was a winding-up order under the 'just and equitable clause' . . . The remedy was, however, often worse than the disease. For, in practice, it generally meant that the business of the company in liquidation

because the break-up value of the assets would in most cases be small and the only available purchaser might be that very majority whose oppression had driven the minority to seek redress.[26]

IMPORTANT LEGISLATIVE CURBS ON ABUSE OF AUTHORITY

Therefore, due to this inefficacy of the available curbs and inspired by section 210 of the English Act, 1948,[27] the Indian Parliament added two sections, namely 153C and 153D to the Companies Act, 1913, by an

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25. contd.....
would have passed into the hands of the majority of shareholders who could ordinarily be the only available purchasers of such a business. As a result of winding-up proceedings, all that would, therefore, happen would be that the business would be taken over by the majority against whose conduct the minority had sought to obtain redress, without the latter being compensated in any way for their interest in it". See para 199.

26. See Report of the (English) Committee on Company Law Amendment, 1946, popularly known as Cohen Committee Report, Cmd. 6659, para 60.

27. In the English Companies Act, 1948 on the recommendation of the Cohen Committee, s.210 was enacted seeking to give greater protection, than hitherto available, to the minority against any high-handedness of the majority.

The first two clauses of s.210, which are relevant here, are as follows:

Minorities
Alternative remedy to winding up in cases of oppression

210. (1) Any member of a company who complains that the affairs of the company are being conducted in a manner oppressive to some part of the members (including himself) . . . may make an application to the court by petition for an order under this section.

(2) If no any such petition the court is of opinion —
(a) that the company's affairs are being conducted as aforesaid; and

Amending Act of 1951. Relevant portions of section 153C were as follows:

ALTERNATIVE REMEDY TO WINDING-UP IN CASES OF . . . OPPRESSION

153C. Power of court to act when company ... oppresses any part of its members. —

(1) . . . any member of a company who complains that the affairs of the company are being conducted —

(b) in a manner oppressive to some part of the members (including himself) may make an application to the court for an order under this section.

(4) If on any such application the court is of opinion —

(a) that the company's affairs are being conducted as aforesaid, and

(b) that to wind up the company would unfairly and materially prejudice the interests of the company or any part of its members, but otherwise the facts would justify the making of a winding up order on the ground that it is just and equitable that the company should be wound up,

the Court may, with a view to bringing to an end the matters complained of, make such order in relation thereto as it thinks fit.

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27. contd.......

(b) that to wind up the company would unfairly prejudice that part of the members, but otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up;

the court may, with a view to bringing to an end the matters complained of, make such orders as it thinks fit, whether for regulating the conduct of the company's affairs in future, or for the purchase of the shares

Some other parts of this section and section 153D elaborated the principle embodied in the parts quoted above and also laid down some qualifications for obtaining relief under these provisions.

Thus by giving to the Court the power to "make such order in relation thereto as it thinks fit" with a view to bringing to an end the oppression of the minority by the majority, the Indian Parliament took a big step forward towards curbing any abuse of authority by the majority to the prejudice of the minority.

When the Indian Companies Act, 1913, was replaced by the Companies Act, 1956, the provisions of sections 153C and 153D were elaborated into eleven sections, namely, sections 397 to 407 of Chapter VI (Part VI); the remaining two sections of that Chapter, namely, sections 408 and 409 conferring powers upon the Central Government to prevent, *inter alia*, oppression, being innovations of the 1956 Act. Relevant provisions of section 153C, quoted above, became section 397,[28] which is as follows:

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27. contd........
of any members of the company by other members of the company or by the company and, in the case of purchase by the company, for the reduction accordingly of the company's capital, or otherwise.

28. Irrelevant parts are omitted. Such parts are the additions made to this section by the Companies (Amendment) Act No. 53 of 1963. By this Amending Act, the words "in a manner prejudicial to public interest or" have been added after the words "are being conducted both in sub-sections (1) and (2)(a).

397. APPLICATION TO COURT FOR RELIEF OF OPPRESSION

> (1) Any members of a company who complain that the affairs of the company are being conducted . . . in a manner oppressive to any member or members (including any one or more of themselves) may apply to the Court for an order under this section, provided such members have a right so to apply in virtue of section 399.
>
> (2) If, on any application under sub-section (1), the Court is of opinion —
>
> (a) that the company's affairs are being conducted . . . in a manner oppressive to any member or members, and
>
> (b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up,
>
> the Court may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.

As is clear from section 153C or section 397, one of the things which the minority must prove in order to avail itself of this remedy, is "oppression", not as a solitary act but as a process. So the first question which arises is what is "oppression".

MEANING OF OPPRESSION

The most celebrated case, which greatly influenced the interpretation of this term both in England and in India, was *Scottish Co-operative Wholesale Society Ltd.* v. *Meyer*.[29]

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29. (1958) 3 W.L.R. 404. See note 101 *infra*.

In this case, Viscount Simonds adopted dictionary meaning of the term "oppressive" as meaning "burdensome, harsh and wrongful".[30] His Lordship said that this term should be interpreted keeping in view the business realities, and not in any narrow legalistic manner. He interpreted it in a way which, in his opinion,[31] would advance the cause for which Parliament enacted s.210 of the (English) Companies Act, 1948. In the same case, Lord Keith observed:

> "Oppression under s.210 may take various forms. It suggests, to my kind as I said in Elder v. Elder & Watson (32), a lack of probity and fair dealing in the affairs of a company to the prejudice of some portion of its members. The section introduces a wide power to the court to deal with such a situation in an equitable manner which it did not have in the case of a company prior to the passing of the Act of 1948". (33)

Six years earlier, Lord President Cooper had interpreted "oppression" as requiring that the conduct complained of "should at the lowest involve a visible departure from the standards of fair dealing, and a violation of the conditions of fair-play on which every shareholder who entrusts his money to a company is entitled

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30. Ibid., at p. 410.
31. Ibid., at p. 411.
32. 1952 S.C. 49.
33. (1958) 3 W.L.R. 404, at p. 429. Emphasis added.

to rely".[34] In the same case, Lord Keith had spoken of "oppression" as connoting "an abuse of power by some person or persons, controlling the company, resulting in injury to the rights of some part of the members".[35]

Lord Justice Jenkins in In re H.R. Harmer, Ltd.,[36] did not agree that section 210 was necessarily confined to cases of discrimination between different shareholders or classes of shareholders though it is expected that cases calling for its application would most usually take that

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34. Elder v. Elder and Watson, Ltd., 1952 S.C. 49, at p. 55. Emphasis added. The wide interpretation given to the term "oppression" in this case was approved by the Jenkins Committee in the following words:

"This statement accords with our own view as to the intention underlying s.210 as originally framed, namely, that it was meant to cover complaints not only to the effect that the affairs of the company were being conducted in a manner oppressive (in the narrower sense) to the members concerned but also to the effect that those affairs were being conducted in a manner unfairly prejudicial to the interest of those members. We think that the section should be amended to make this clear . . ." Report of the Company Law Committee, 1962, Cmnd. 1749, para. 204. Emphasis added.

35. 1952 S.C. 49, at p. 60. Emphasis added. But B.H. MacPherson thinks that notwithstanding Lord Keith's mention of "injury to the rights", it is not necessary for the complaining shareholder to show that he has suffered injury to something to which he has a strict legal entitlement. According to him, it is sufficient for the complaining shareholder to prove that the conduct of the majority, even though it may be technically correct, involves a departure from the standards of fair-play. See "Oppression of Minority Shareholders, Part II: Statutory Relief", 36 Austl. L.J., 427 at pp. 431-432 (1962-1963).

36. (1958) 3 All. E.R. 689.

form. His Lordship also did not agree that it was essential to a case of oppression that the alleged oppressor was oppressing in order to obtain pecuniary benefit. "If there is oppression, it remains oppression even though the oppression is due simply to the controlling shareholders' overweening desire for power and control and not with a view to his own pecuniary advantage. The result rather than the motive is the material thing".[37]

The Indian courts have throughout been approving and adopting these definitions of "oppression". Thus, it is clear that, in India too, "oppression of minority" means an abuse of authority by the majority which is violative of the standards of fair dealing towards the minority, whether it be discriminatory to the minority or not and whether the majority obtains some pecuniary benefit out of it or not.

INDIAN INSTANCES OF OPPRESSION AND THE RELIEFS GRANTED

In *In re Hindustan Co-operative Insurance Society Ltd.*,[38] the facts briefly were as follows: The company was carrying on life insurance business. After nationalisation of life insurance business on 19-1-1956, the company's assets and liabilities vested in the Life Insurance Corporation. The compensation which the company obtained from

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37. *Ibid.*, at p. 704.

38. A.I.R. 1961 Cal. 443.

the Corporation, the directors of the company retained with them and did not distribute among the shareholders who were entitled to it. Since 19-1-1956, the directors of the company, who had the majority backing, did not call any general meeting of the company; nor did they make any effort or gesture to place before the shareholders the balance-sheet of the year ending 31st December 1955. As a matter of fact, the shareholders of the company were kept completely in the dark as to what was being dome with regard to the company's affairs. Under the articles of association, one third of the directors were required to retire every year by rotation. But the directors continued wrongfully to function as such and to hold the board meetings; they dealt with the company's money in any fashion they liked. Finally, by resolutions passed at their meetings in 1959 they attempted to force accounts for the periods 1956, 1957 and 1958 on the minority shareholders. Moreover, they attempted to continue the corporate existence of the company and to utilise the compensation money for purposes other than the principal object which had become impossible of being pursued.

The minority shareholders, holding more than one-tenth of the issued share capital, moved a petition alleging, inter alia, oppression and asked for relief,

inter alia, under section 397 and its supplementary sections[39] of the Companies Act, 1956.

Justice U.C. Law held the opinion that by the resolutions passed at the meetings held in 1959, the so-called (many of whom had actually ceased to be directors) directors, who had the majority voting power, attempted to force the minority to invest their money in a different kind of business against their will. The minority share-holders had invested in life insurance business with all

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39. In Chapter VI of Part VI of Companies Act, 1956, of which sections 397 and 398 form part, the scheme is like this. Section 397 deals with "oppression" and "conducting the affairs of a company in a manner prejudicial to public interest". Section 398 deals with "conducting the affairs of a company in a manner prejudicial to its own interests" and "conducting the affairs of a company in a manner prejudicial to public interest". All the remaining sections of this Chapter (except sections 408 and 409) lay down rules which are equally applicable to cases coming under section 397 as well as section 398. Section 399 lays down rules in regard to "Right to apply under sections 397 and 398"; section 400 in regard to "Notice to be given to Central Government of applications under sections 397 and 398"; section 401 in regard to "Right of Central Government to apply under sections 397 and 398", section 402 in regard to "powers of Court on application under section 397 or 398"; section 403 in regard to "Interim order by Court"; section 404 in regard to "Effect of alteration of memorandum or articles of company by order under section 397 of 398"; section 405 in regard to "Addition of respondents to application under section 397 or 398"; section 406 in regard to "Application of sections 539 to 544 to proceedings under section 397 and 398"; and section 407 in regard to "Consequences of termination or modification of certain agreements" under section 397 or 398. Thus sections from 399 to 407, both inclusive, lay down

its safeguards and statutory protection. They were now being forced to invest where there would be no such protection or safeguard. "Further it must not be overlooked that the shares of the company are only partly-paid to the extent of Rs.25 per share value of Rs.100 each and in case the company is to continue and carry on a different business as the so-called Directors are attempting to do with their superior voting power the applicants may in future be forced to pay the uncalled balance of Rs.75 per share in a business which they do not wish to carry on and that would undoubtedly be 'burdensome, harsh and wrongful' to the applicants".[40]

His Lordship further observed:

> "By adopting such attitude the Directors-respondents failed to behave with scrupulous fairness to the minority shareholders as was incumbent on them as holding a position of trust. They further failed to maintain the <u>utmost good faith</u> between themselves and the minority shareholders by their unlawful conduct of the affairs of the company so that the minority shareholders were driven to apply under these sections for an order, <u>inter alia</u>, for appointment of a Special Officer and also for an order that the company do purchase the shares including theirs at a valuation. Such a remedy is permissible under section 402 of the Companies Act, 1956. I have no doubt that this is a case where the powers under Ss.397 . . . and 402 of the Companies Act should be justly invoked". (41)

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39. Contd....... something or the other in regard to the relief available under section 397 and can therefore be called its supplementary sections. Equally these sections can be said to be supplementary to section 398 also.

40. A.I.R. 1961 Cal.443, at p. 453.

It was argued before the learned Judge that s. 397 aims at preventing an active company from going to a winding-up, suggesting that it does not apply to a company which is not in active business. Denying this suggestion, his Lordship observed:

> "The object of the remedy is to bring to an end the matters complained of, that is 'oppression' and this can be done even though the business of the company has been brought to a stand-still". (42)

For these reasons, his Lordship concluded that the directors were exercising their authority oppressively to the petitioners. His Lordship therefore appointed a special officer and directed him, among other things, to purchase on behalf of the company the shares of the applicants and their supporters (that is, the complaining minority) at a valuation arrived at according to a formula indicated by the Court.

In another case which in the first appellate stage appeared as Rajahmundry Electric Supply Corporation Ltd. v. Nageshwar Rao,[43] the petitioner, one of the share-holders of the company, filed a petition under section 162(5) and (6) and s.153C of the Indian Companies Act, 1913, for winding-up the company or, in the alternative, for taking action under section 153C. He alleged that

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42. Ibid.
43. (1956) Andh. L.T. 207.

he had obtained the consent of 80 shareholders, that is, more than 1/10th of the total number of shareholders. He made grave and serious allegations against the directors and alleged that the affairs of the company were being conducted in a manner oppressive to the petitioner and the other shareholders who did not belong to the group of directors. It was further alleged "that the present management, relying on brute majority, are ruling despotically".[44]

At the trial stage, Justice Bhimasankaram allowed the petition and under section 153C of the Indian Companies Act, 1913, superseded the Board of Directors by two administrators for a period of six months tentatively, giving them all powers of management which vested in the board of directors of the company. This order of the trial Judge was upheld by a Division Bench of the Andhra High Court[45] and was further upheld at the second appellate stage by the Supreme Court.[46] Though oppression of the minority was alleged, this case falls predominantly within the purview of the next Chapter where it will receive a detailed treatment. It is not therefore being discussed here any further.

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44. Ibid., at p. 209. Emphasis supplied.
45. (1956) Andh. L.T. 207. The Division Bench consisted of K.Subba Rao, C.J., and Krishna Rao, J.
46. Rajahmundry Electric Supply Corporation Ltd., v. Nageshwara Rao, (1956) 1 M.L.J. 95. The Supreme Court Bench consisted of Vivian Bose and T.L. Venkatarama Ayyar, JJ.

A case of very great importance in this connection is Shanti Prasad Jain v. Kalinga Tubes, Ltd.[47] Mr. Shanti Prasad Jain, who was leader of a minority group in Kalinga Tubes Ltd., filed a petition under, inter alia, section 397 and its supplementary sections of the (Indian) Companies Act, 1956, alleging that the majority group (which actually consisted of two groups) was pursuing a continuous process of oppression towards his group. He also alleged that the majority group, in their craze to oppress the minority, was following a policy by which they were also ignoring the interests of the Company and so mismanaging the Company's affairs to the prejudice of the Company.

In order to correctly appreciate the points arising out of this case, it is necessary to narrate here a brief history of the Company and its affairs. It was incorporated as a private limited company on December 1, 1950, with its registered office in Orissa and with an authorised capital of Rs.25 lacs. The Company acquired lands, but did not go into production until several years after its incorporation. Respondent No.2, Shri Patnaik and respondent No. 4, Shri C.S. Loganathan, were the two

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47. A.I.R. 1962 Ori. 202.

major shareholders. They had complete control over the affairs of the Company. Prior to 1954, the Company was under heavy debts and was in real financial difficulty. The shareholders had divided themselves into two groups, namely, the Orissa group represented by Shri Patnaik, and the Madras Group represented by Shri Loganathan. During this period, the petitioner, Shri S.P. Jain was not in the picture at all.

In the middle of June 1954, the Company, which was then badly in need of capital, was introduced to the petitioner, Shri S.P. Jain, by the Secretary, Industries and Development Department, Government of Orissa. Through the continued efforts of this Secretary, Shri S.P. Jain came to the rescue of this company. There was correspondence between Shri Patnaik and Shri S.P. Jain in which various matters were clarified and the terms of Shri S.P. Jain's association with the Company were settled. These terms, inter alia, were that Shri S.P. Jain would supply money towards the capital of the Company equal to that supplied by each of Shri Patnaik and Shri Loganathan; that any capital required in future would be found in equal measure by the three principal shareholders — Jain, Patnaik and Loganathan; that Shri S.P. Jain would be the chairman of the board of directors; that Shri Patnaik would be the managing director; that Shri Shital Prasad, a relation of

Jain, would be the joint managing director; and that Shri S.P. Jain would provide banking facilities upto Rs.50 lacs for importation of raw materials. On July 27, 1954, there was a Memorandum of Oral Agreement between Shri S.P. Jain as the first party, Shri Patnaik as the second party and Shri Loganathan and two other shareholders (all of Madras) as the third party, signed by all these parties and recording the above-given terms of the agreement between the parties as partners of the Company which was then a private limited company.

This agreement became a bone of contention, the petitioner's case being that it was binding and it was acted upon while the respondents alleged that it was not binding, nor was it acted upon. Whatever might have been the truth about its having been acted upon, but the facts remained that, after the agreement, the board was reconstituted; Shri Shanti Prasad Jain was made the chairman of the board; from the date of the agreement until the dispute arose, the allotment of shares was always confined to the three groups in equal proportion, and some other changes were effected which were the same as contained in the terms of the agreement . Shri S.P. Jain continued to act as the chairman; procured huge credit facilities from banks for the Company and it can be reasonably surmised that but for these credit facilities,

the Company could not have raised itself to its present status as a prosperous growing concern.[48] In January, 1957, by the consent of all the three groups, the Company was converted into a public company.

The next chapter in this story opens in March, 1958, and relates to the issue of 39,000 ordinary shares. On March 1, 1958, a notice was issued for an extra-ordinary general meeting to be held on March 29, 1958, for the purpose of considering, inter alia, the "manner and proportion" in which such shares should be issued. The explanatory statement said that the increase in share capital was necessary in the interests of the company, and that the money was urgently needed for the purpose of expansion of the company's business. At the extra-ordinary general meeting on March 29, Shri S.P. Jain was not personally present. At this meeting, a resolution was moved by respondent no.3, Mrs. Gyan Patnaik, that the said 39,000 shares should not be offered or allotted to the existing shareholders or to the public. To this resolution an amendment was moved by two members of the Jain group but the amendment, when put to vote, was declared lost, and Mrs. Patnaik's resolution was passed. In pursuance of this resolution, ignoring intermediate stages of the story which are not strictly relevant, these

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48. See ibid., at p. 205, col.2.

39,000 shares were alloted by the directors at their meeting on July 30, 1958, to outsiders privately, that is, without inviting any public offers.

There was a further attempt to raise the capital of the company from Rs. one crore to Rs. 3 crores. A notice was issued of an extraordinary general meeting to be held on September 21, 1960. The explanatory statement attached to the notice stated that the shares in the Company should be offered to outsiders, that is, persons other than the existing shareholders and as much capital as possible should be raised from such outsiders; that this would ensure that the structure of the Company would be further broad-based and the shares would be held by various independent persons.

After receiving this notice, Shri S.P. Jain file this petition on September 14, 1960. His main grounds were that the two rival groups were following a policy of oppression against the petitioner and his group who were in minority, with a view to excluding the petitioner and his group completely from all control of the Company's affairs. He alleged that the object of the rival groups was to obtain 75 per cent. of the voting power in the Company; and that, in view of these wrongful acts of the rival groups who had combined together, there had arisen

a justifiable lack of confidence on the part of the petitioner and his group in the conduct and management of the affairs of the Company.

Justice Barman held that the petition was maintainable and that the conduct of the respondents was certainly oppressive to the petitioner. His Lordship thought that it was not a case of a solitary act of oppression but showed a continuous policy of oppression practised against the petitioner and his group by the majority. In Justice Barman's opinion, the facts here were sufficient grounds for a winding-up order of the Company under the "just and equitable" rule because the respondents by their continued conduct towards the minority had shaken the minority's confidence in the probity with which the Company's affairs were being conducted. But his Lordship held that winding-up would be prejudicial to the interests of the minority. His Lordship thought that the majority's conduct aimed at excluding the minority from any control, so that ultimately the minority, out of disgust, might sell away their shares to the majority at a nominal value.

His Lordship ordered the two holders of 39,000 shares, namely, the Central Bank of India Ltd., and Shri Bijoy Kumar Mall, to sell 13,000 shares, 10,000 and 3,000 respectively out of their respective holdings of

30,000 and 9,000 shares, to the petitioner or his nominees who were members of the Company. His Lordship reconstituted the board so as to give equal representation to the three groups. This was only as a temporary measure. As a permanent measure, his Lordship changed the Company's articles of association so that they included the method of election of directors under the system of proportional representation by single transferable vote.[49] Further, the Company was restrained from effecting any increase of capital before giving effect to this order.

This decision, together with that of the Calcutta High Court in In re Hindusthan Co-operative Insurance Society, Ltd.,[50] gave hope to company lawyers that the new provisions regarding "oppression" would be liberally interpreted and that these provisions would prove to be an important bulwark for protection of minority interests. But this hope was completely belied

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49. This particular part of the order has been criticised on the ground that the Court did not have the power to order the Company to adopt the system of proportional representation as this power beloged to the Central Government under s.408. But the Editor of the Journal has expressed his doubts about the soundness of this criticism. The rest of the order has been approved. See K.S.N. Murthy, "Minority Protection under Company Law", (1964) 1 Comp. L.J. 113, at p. 118.

50. See supra.

by reversal of this decision by a division bench of the Orissa High Court.[51] R.K. Das and G.K. Misra, JJ., held, inter alia, that the petitioner could not prove "oppression".

The reasons given by the Court were as follows:

> "The core of Mr. Mitra's (petitioner's counsel) argument that the status quo conceived in the terms of the Oral Agreement should be maintained cannot be taken into consideration in exercise of jurisdiction under s.397. Non-distribution of one-third shares to the petitioner in proportion to the existing share-holdings had undoubtedly led to lack of confidence and private animosity between the majority group and the minority group in the matter of policy and administration of the company. But the Directors of the company concerned with the management of the affairs cannot be charged with fraud, misfeasance or misconduct towards any parts of its members. It cannot be said that the Directors controlling the Company have abused their powers resulting in injury to the rights of the minorities unless it is assumed that the minorities are entitled as of right to proportionate one-third distribution of the newly issued shares". (52)

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51. Kalinga Tubes Ltd. v. Shanti Prasad Jain, A.I.R. 1963 Ori. 189.

52. Ibid., at p. 209, para 34. This passage is from the judgment of Misra, J., but it can rightly be treated as a passage from the judgment of the Court since Das, J., agreed with Misra, J.'s judgment and delivered a brief judgment touching only on the question of validity of the notice for the extraordinary general meeting of 29th March, 1958. Therefore passages or opinions taken from the judgment of Misra J., on questions other than those which Das, J., also dealt with will, in future also, be referred to as passages or opinions from the judgment of the Court.

The judgment further said:

> "If the particulars alleged subsequent to the filing of the application are ruled out of consideration, there are no other facts constituting a part of a consecutive story leading to oppression, excepting the single fact that the 39,000 shares were not distributed amongst the shareholders in proportion to their existing shareholding. Even if it can be characterised as amounting to an act of oppression, it does not amount to a continuing and continuous process of oppression". (53)

And for these reasons, the judgment on the issue of maintainability of the petition under s.397 concluded:

> "The petitioner has failed to make out a case under s. 397". (54)

These reasons can be resolved into the following points:

Reason I: The argument that the status quo conceived in terms of the agreement should be maintained cannot be taken into consideration in exercise of jurisdiction under s. 397.

Reason II: The minority was not entitled as of right to participate in the new issue of shares.

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53. Ibid.
54. Ibid.

Reason III:- <u>Therefore, by non-distribution of one-third of the new shares to the petitioner, the majority was not guilty of any fraud, misfeasance or misconduct towards any of the company's members. Further, the majority did not abuse their powers resulting in injury to the rights of the minority</u>.

Reason IV: <u>There is no other act constituting a part of a consecutive story leading to "oppression" except this act of exclusion of the petitioner from a share in the issue of 39,000 shares. Even if this act may be characterised as amounting to an act of oppression, it does not amount to a continuing and continuous process of oppression as required under s. 397</u>.

Reason V: <u>Non-distribution of one-third shares to the petitioner undoubtedly led to lack of confidence and private animosity between the majority group and the minority group in the matter of policy and administration of the company. But this lack of confidence and private animosity are not sufficient for winding up the company under the "just and equitable" rule and therefore are not sufficient to attract the application of s.397</u>.

It is now proposed respectfully to scrutinise these reasons.

Reasons I & V will be dealt with together.

Reasons I & V: In this connection, it should not be forgotton that the petitioner's main grievance, which occasioned the moving of this petition by him, was that he was excluded from sharing in the issue of 30,000 shares in 1958 and again there was a move to exclude him from a further issue of shares as was evident from the explanatory statement attached to the notice for calling an extra-ordinary general meeting to be held on September 21, 1960.[55] Without going into the question whether the written agreement of July 27, 1954, was binding on the parties or not, at least one thing emerges quite clearly from the facts of this case. And that is that irrespective of whether the agreement was binding or not, it cannot be denied that there was an understanding given to Mr. S.P. Jain that he would be offered shares proportionate to his capital in any further issue of shares. It was this understanding which tempted Mr. Jain to help the Company in its critical days. If someone comes to the help of a company in its days of ill-luck because of a certain understanding and later on that understanding is evaded under one pretext or

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55. See the brief history of the Company and its affairs, supra.

the other, the whole transaction may not be legally blameworthy but it cannot escape being morally reprehensible. If so, it shows "a lack of probity and fair dealing in the affairs of a company to the prejudice of some portion of its members";[56] or involves "a visible departure from the standards of fair dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely",[57] or it evidences that the majority "failed to maintain the utmost good faith between themselves and the minority shareholders"[58] in the conduct of the affairs of the Company.

Speaking of the remedy under s.397, an Indian company lawyer said:

> "It will be observed that in order to attract the new statutory jurisdiction of the court, the petitioner must be able to allege and prove facts which would justify the making of a winding up order on the ground that it was 'just and equitable' to do so . . . . Often a public company is in substance,

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56. Lord Keith's definition of "oppression" in Scottish Co-operative Wholesale Society Ltd. v. Meyer, (1958) 3 W.L.R. 404, at p. 429; see supra under the heading "Meaning of Oppression".

57. Lord President Cooper's definition of "oppression" in Elder v. Elder and Watson Ltd., (1952) S.C. 49 at p. 55; see supra, under the heading "Meaning of Oppression".

58. Mr. Justice Law's definition of "oppression" in In re Hindusthan Co-operative Insurance Society Ltd., A.I.R. 1961 Cal. 443, at p. 453. See supra.

> though not in law, a partnership consisting of the majority and the minority shareholders. In such cases, as Lord Keith observed in the Scottish case, there should be the utmost good faith between the constituent members. In such concerns the members usually join the venture pursuant to some arrangement or some understanding between them. The test of the application of the 'just and equitable' rule in such cases would be to consider whether a situation has arisen as a result of the majority conduct which is quite outside what the members contemplated by their original understanding. If the answer be in affirmative, the test is satisfied even though the acts complained of are not in excess of the powers of the majority and are technically legal and correct". (59)

As to Reason V, it should further be noted that it was not a case of mere lack of confidence and private animosity between the majority group and the minority group in the matter of policy and administration of the Company. But it was a case of lack of confidence in the probity with which the majority was conducting the affairs of the Company. As Barman, J., had rightly held at the trial, the majority was pursuing a deliberate policy of making the minority ineffective with a view ultimately to

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59. Subrata Roy Chowdhry, "Freezeout Problems in Corporation Law", Proceedings of the Seminar on Current Problems of Corporate Law, Management and Practice, 273 at p. 282. Emphasis added. This Seminar was held in 1962 and its proceedings were published by the Indian Law Institute, New Delhi in 1964. While making this statement, Mr. Roy Chowdhry refers to Palmer's Company Precedents, 17th edition, Part II, pp. 34-35, footnote.

compelling it to leave the Company. This was not a mere difference of opinion as to how the affairs of the Company should be conducted. It was a grave matter which shook the confidence of the minority in the *bona fides* of the majority towards it. For these reasons, Barman, J., rightly held: "It is the settled position in law that such oppression of minority shareholders is itself sufficient for winding up, on the ground that is "just and equitable' that the company should be wound up".[60]

It is therefore respectfully submitted that Reasons I & V of the division bench do not appear to be sound.

Reason II. Leaving aside the question of the minority's right to a share in the new issue based on the agreement or understanding, which has been adequately discussed under head I above, the question will now be discussed on the basis of provisions of company law.

The relevant section of the Companies Act, 1956, is section 81. The relevant provisions of this section at the relevant time[61] were as follows:

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60. A.I.R. 1962 Ori. 202, at p. 213, para 23.

61. Relevant time here means the time when the 39,000 shares were allotted in 1958. In 1960 these provisions were amended. See *infra*, note 64.

81. <u>Further issue of Capital</u>

(1) Where at any time subsequent to the first allotment of shares in a company, it is proposed to increase the subscribed capital of the company by the issue of new shares, then subject to any directions to the contrary which may be given by the company in general meeting, and subject only to those directions —

(a) Such new shares shall be offered to the persons who, at the date of the offer, are holders of the equity shares of the company in proportion, as nearly as circumstances admit, to the capital paid on those shares at that date;

(b) the offer aforesaid shall be made by notice specifying the number of shares offered and limiting a time not being less than 15 days from the date of the offer within which the offer, if not accepted, will be deemed to have been declined;

(c) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in cl.(b) shall contain a statement of this right;

(d) after the expiry of the time specified in the notice aforesaid or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of directors may dispose of them in such manner as they think most beneficial to the company.

It is quite clear from these elaborate provisions, that the Act gave to the existing equity shareholders a

right[62] to share in any fresh issue and that this right to share was to be in proportion to the capital paid up on their existing shares at the date of the fresh issue. It is quite another thing that this right could be altered by the general meeting. But it does not mean that there was no right. Every citizen in India has a right to own property. In suitable circumstances, the State has the power to deprive the citizen of his property. It does not mean that it can justifiably be said that the citizen has no right to own property.

This right is known as the pre-emptive right of the existing shareholders and is a very important right for the protection of minority interests.[63] It has been the consistent policy of the Indian Legislature to

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62. Speaking about s.81, K.M. Ghosh in his book, The Indian Company Law, Part I (11th ed.,1963), says at p.276: "This section limits the powers of directors to dispose of the further issue of capital in any manner, they may think most beneficial to the company. They are under a mandate to offer those shares in the first instance to the members in proportion to their existing shares. Thus a member becomes entitled to obtain shares in the further issue of shares as of right". (Emphasis added). For this statement, the learned author relies on Mathalone v. Bombay Life Ass. Co., A.I.R. 1953 S.C. 385.

63. For a detailed examination of this important right, please see, Mr. Justice P.N. Bhagwati, "Rights of Minority Shareholders", Proceedings of the Seminar on Current Problems of Corporate Law, Management and Practice, 247 at pp.254-257.

strengthen[64] this right of the minority.

In the United States, most jurisdictions recognise this right.[65] Deprivation of this right constitutes an important part of the process known as "freezing-out"[66] the minority. Speaking of the rationale of this right, Mr. Justice Pitney in Joshua W. Miles v. Safe Deposit and Trust Co. of Baltimore observed:

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64. Prior to 1936, it was provided only in Table A of the First Schedule to the Indian Companies Act, 1913. But adoption of Table A being optional at the will of companies, shareholders in all the companies did not enjoy this right. Then in 1936, s. 105C was inserted in the Act itself giving this right to existing shareholders in all companies. In 1960, this right was made alterable only by a special resolution and not by an ordinary resolution, thus making the right more difficult to be taken away. But even this does not meet with the wishes of company lawyers. See Subrata Roy Chowdhry, op.cit., at pp. 276-277, where he suggests that a special resolution denying the existing shareholders their pre-emptive right should not take effect unless it has further been sanctioned by the Central Government which should, before granting its sanction, take into consideration the wishes of the minority also and should satisfy itself that the proposal contained in the special resolution is most beneficial to the interests of the company. Alternatively, he suggests that a resolution denying the pre-emptive right, in order to be effective, should be required to have to be passed by a greater percentage of votes than what is required for a special resolution.

65. See 74 Harv. L. Rev., 1630-1631 (1960-61).

66. This term has been defined as "the use of the corporate control vested in the statutory majority of shareholders or the board of directors to eliminate minority shareholders from the enterprise, to reduce to relative insignificance their voting power or claims on corporate income or advantages". See ibid., at p. 1630.

"The right to subscribe to the new stock was but a right to participate, in preference to strangers, and on equal terms with other existing shareholders, in the privilege of contributing new capital called for by the corporation, — an equity that inheres in stock ownership under such circumstances as a quality inseparable from the capital interest represented by the old stock, recognised so universally as to have become axiomatic in American Corporation Law". (67)

Leaving aside the American position, it is quite clear from what has been said above about the Indian position, that the existing shareholders, including the minority shareholders, were entitled as of right, to participate in the new issue of shares.

Reason III

Even if the majority committed no fraud or misfeasance, it cannot be denied that the majority abused their powers resulting in injury to the rights of the minority. It is undoubtedly true that the general meeting or, in other words, the majority had the power under section 81 of the Companies Act, 1956, to displace the pre-emptive right. But the displacement should be for some good cause. It should be shown that it was bona fide for the benefit of the company as a whole.[68] It was argued on behalf of the

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67. 259 U.S. 247 at p. 252; 66 L.Ed.923, at p. 926.

68. Speaking of the power of majority to bind a minority, Lord Lindley in Allen v. Gold Reefs of West Africa, (1900) 1 Ch. 656, at p. 671 had observed:

Company or, in other words, the majority that (1) the Company needed capital immediately and that (2) they wanted to make the structure of the Company broad-based.

The Company was not made any appreciably broader-based because at the time of this petition only two shareholders were holding all the 39,000 shares.[69]

The Company certainly needed capital immediately, but that did not necessarily require that the pre-emptive right should have been taken away, as in this case the minority shareholders were prepared to pay the entire amount due on 13,000 shares immediately. If the majority shareholders were not in a position to pay for their shares immediately, they could have renounced those shares in favour of their nominees. In this manner, from the minority

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68. contd.......
"Wide, however, as the language of . . . is, the power conferred by it must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised not only in the manner required by law, but also bona fide for the benefit of the company as a whole, and it must not be exceeded. These conditions are always implied, and are seldom, if ever, expressed". Emphasis added.
And Jagadish Swarup in his book, The Companies Act, 1956, Vol. I, at pp.113-114 is of the opinion: "A resolution passed by a majority may be challenged on the ground that it was not passed bona fide and in the interest of the company as a whole".

69. See A.I.R. 1962 Ori. 202, at p. 212, para 21.

shareholders alone, the Company could have immediately received Rs.13,00,000. Whereas, the position now was that even after March 31, 1959, the unpaid calls amounted to Rs. 33,15,000; which meant that the Company in the course of eight months[70] received only Rs.5,85,000 which was less than half of what the Company could have immediately received from the minority shareholders alone. Even after 31st March, 1960, Rs.7,65,000 were still outstanding on unpaid calls. While these unpaid call moneys were left outstanding, the Company was still taking loans and paying interest. The balance-sheet for the year 1958-59 showed that the Company was paying interest to the tune of Rs.5,67,718. By realising the unpaid call moneys immediately, the Company's liability to pay interest could have been reduced. If the shareholders did not pay the call moneys according to the terms of the issue, the Company could have forfeited the shares and then could have re-allotted them to persons who were prepared to pay money immediately. But this was not done.

It was for these reasons that Justice Barman, at the trial, had held:

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70. That is, between July 30, 1958 (when the 39,000 shares were allotted) and March 31, 1959 (when the balance-sheet for the year 1958-59 was prepared).

"Thus, it is clear that the interest of the company was not at all in the mind of those in the management of the company at the time. In fact the company was in need of funds, and it would have been in the interest of the company to raise moneys quickly by offering the shares to the existing shareholders, who were ready to have them on full payment of the entire consideration; instead, the rival groups, with a view to oust the minority group, took recourse to measures by reason of which the company's interests itself suffered, because on the one hand they were taking loans and paying interest to Banks and others, while the unpaid shares money for the said 39,000 shares were being left outstanding even as late at 1960, that is to say, two years after the allotment of the said shares in July 1958" (71)

In the circumstances, as narrated above, it is difficult not to agree with this holding of Justice Barman, and therefore the conclusion seems to be irresistible that the majority took away the pre-emptive right of the minority not in the interest of the Company but against the Company's interests.

As written above, the majority did not have the power to displace the pre-emptive right except when it was for the benefit of the Company to do so. As such, it was a clear abuse of powers by the majority and it certainly injured the pre-emptive right of the minority, and the benefits flowing therefrom to them.

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71. A.I.R. 1962 Ori.202, at p. 212, para 19. Emphasis added.

Reason IV

The exclusion of the petitioner from the issue of 39,000 shares in 1958 was not the only act done by the majority to oppress the minority. As has been said before, on August 25, 1960, there was a notice for holding an extraordinary general meeting on September 21, 1960, for the purpose of further increasing the share capital from Rs. one crores to Rs. three crores. At this meeting, a special resolution[72] was also to be proposed, seeking to debar the existing shareholders from a share in the fresh issue.

It was after this attempt directed at further exclusion of the minority came to the notice of the petitioner, that he moved the present petition. And it is quite certain that had the Court not intervened by granting an order of interim injunction restraining the Company and the rival groups from proceeding further with the proposed issue, the attempt would have ripened into an accomplished act. It is thus clear that the majority

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72. It may be mentioned here that at that time a special resolution was not necessary for debarring the existing shareholders from the fresh issue since the amendment in s.81, making a special resolution necessary for this purpose, came into force later in 1960. But since the majority now, after the allotment of 39,000 shares to their friends or nominees, commanded more than 75% votes, it appears that in order to make a show of their strength, they sought to do a thing by a special resolution which they could easily have done by an ordinary resolution.

had done everything in their power to launch on a second offensive to oppress the minority. If they did not succeed, it was because of reasons beyond their control. It is therefore incorrect to say that there was no other act constituting a part of a consecutive story leading to "oppression" except the act of exclusion of the petitioner from the issue of 39,000 shares.

Even if this later attempt of the majority be ignored for a while, there is authority[73] to say that if a single wrongful act is such, that its effect will be a continuous course of oppression and there is no prospect of the situation being remedied by voluntary acts of the party responsible for the wrongful acts, the court is entitled to interfere by an appropriate order under section 397. In the present case, there is no doubt that the single wrongful act of excluding the minority from the issue of 39,000 shares had the effect of giving the majority group more than 75% voting power, which they did not possess before,[74] or in other words had the effect

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73. See In re Sindhri Iron Foundry (Private) Ltd., 68 Cal. W.N. 118 (1963-64), decided by B.C. Mitra, J. Though this case was of an unusual type, namely, of oppression of majority by minority, but this part of the judgment has nothing in it which makes it inapplicable to a case of the usual type or, for that matter, to a case like the present.

74. See the Table showing voting strength at different stages, given at p. 206 of the division bench judgment in A.I.R. 1963 Ori. 189.

of giving the majority group a long stick by which it could beat the minority more effectively than it could do before. This single wrongful act did not only increase the majority's potential to oppress, but also its desire to oppress, as is evidenced by the terms of the proposed issue. And there was no prospect of the situation being remedied by the voluntary acts of the parties responsible for the wrongful acts.

In view of these reasons, it is submitted, that the view on the matter of "oppression" taken by Justice Barman, at the trial stage, is far more preferable than the view taken by the division bench.

This decision of the division bench has only recently been upheld[75] by the Supreme Court. The judgment of the Supreme Court has nothing new in it. The arguments given by the Court against the appellant do not bear scrutiny in the light of what has been said above in connection with the examination of five points into which the reasons for decision of the division bench have been split up. To take but one instance, of course an important one, since it appears to be one of the main reasons supporting the decision, the Court observed:

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75. See _Shanti Prasad Jain v. Kalinga Tubes Limited_,(1965) 1 Comp. L.J. 193; (1965) 35 Comp.Cas.351. The Supreme Court bench consisted of P.B. Gajendragadkar,C.J., K.N. Wanchoo and S.M. Sikri JJ. Judgment of the Court was delivered by Wancho,J., on January 14, 1965.

> "It also appears that the Patnaik group was afraid at the time when the new shares were being issued that as they had no money the appellant group would take up the entire new issue and would thus obtain majority control of the Company. This they wanted to avoid and that is why the new issue was resolved in general meeting to be issued to others and not to the existing shareholders. If this was the reason why new shares were not issued to the existing shareholders it can hardly be said that the action of the majority shareholders in passing the resolution which they did on 29th March, 1958, was oppressive to the minority shareholders". (76)

This argument was pressed into service at places more than one[77] in the course of judgment, to counter the appellant's allegation of "oppression".

It is respectfully submitted that this argument is unsound and for the following reasons. If the shares worth Rs.39 lacs were offered to the existing shareholders in accordance with section 81 of the Companies Act, 1956, and if the Patnaik and Loganathan groups did not have the money to take their quota of shares, as they alleged, it was not all necessary that Jain group could have compulsorily taken all the shares worth Rs.39 lacs, as the Supreme

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76. (1965) 1 Comp. L.J. 193, at p. 207.

77. For example, see ibid., at p. 209. "If the fear of Patnaik was correct that the appellant would have purchased all the shares worth Rs.39 lacs for want of money on the part of Patnaik and Loganathan groups and would thus have obtained a dominating position in the Company, the action of the majority shareholders in preventing such domination by one group only and taking action for that purpose cannot in the circumstances be said to be oppressive of the minority shareholders".

Court says. Section 81, in the shape in which it existed at the relevant time, has already been quoted in connection with the discussion of Reason II of the division bench judgment. Sub-section (1)(c) of this section provided that the offer of new shares to the existing shareholders would be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of <u>any other person.</u>

Thus Patnaik and Loganathan groups could have renounced the offers to them in favour of their friends to whom the entire new issue now went. In this manner, Jain group could have got only one-third and two-third part of the new issue would still have remained with the Patnaik — Loganathan group; thus increasing their relative majority even further, instead of giving majority control to the Jain group, as the Supreme Court has said. As has been already said, subsection (1)(c) of section 81 permitted renunciation of the offered shares in favour of <u>any other person</u>. It did not say that they could be renounced in favour of <u>the existing shareholders only</u>. This fact, unfortunately, seems to have escaped the attention of the Supreme Court.

It is not proposed to discuss all the reasons for their decision given by the Supreme Court, but it can be safely said, in brief, that the Supreme Court in this

case took a very legalistic and mechanical view of the provisions of section 397.

In Mohan Lal Chandumall v. Punjab Company Ltd.,[78] in which the petitioners were majority shareholders,[79] Justice Tek Chand upheld the petitioners' plea of oppression when they were being deprived of their right to vote and the right to receive dividends, and observed:

> "Section 397 provides relief, inter alia, where the Court is of the opinion that the company's affairs are being conducted in a manner oppressive to any member or members. In this case the non-voting members are being subjected to hardship or burden which may truly be called oppressive. They are subjected to an oppressive conduct in so far as they are being dominated and have to submit to excessive use of authority. Such a conduct amounts to unjust hardship. To oppress, ordinarily, means to crush, smother or trample. In this case, their valuable rights are being trampled upon by unjust exercise of authority or power. To take away the rights of partaking in dividends earned by their contribution is not merely oppressive but even confiscatory". (80)

His Lordship allowed the petition under section 397 and directed the Company to purchase the shares of the petitioners and their group of non-trading members.

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78. A.I.R. 1961 Punj. 485.

79. At the suit of majority shareholders, relief under these provisions was granted in two other cases also, namely, (1) In re Sindhri Iron Foundry (P) Ltd.,(1964) 34 Comp. Cas. 510, and (2) In re Clive Mills Co. Ltd., (1964) 34 Comp. Cas. 731.

80. A.I.R. 1961 Punj. 485, at pp. 488-489. Emphasis added.

INSTANCES WHEN REMEDY UNDER SECTION 397 REFUSED

In Lalita Rajya Lakshmi v. Indian Motor Co. Ltd.,[81] P.B. Mukerji and U.C. Law, JJ., held that denial of access to, or inspection of, the books of account of the company to a minority shareholder[82], was not an act of oppression within the meaning of section 397 because a shareholder had no such right recognised by the Companies Act. Further, their Lordships held that the fact that a division had been declared which was much below the actual profit earned by the company, could not be an act of oppression because a shareholder had no right to have any particular dividend declared; the board of directors having discretion whether to declare a dividend and to fix the rate of such dividend. As it is doubtful that an injury to a legal right is essential for oppression,[83] it is suggested that this decision should be confined to the particular facts of this case and should not be given a general application.[84]

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81. A.I.R. 1962 Cal. 127.

82. This shareholder who moved the petition held more than 30 per cent. of the shares.

83. See note 35, supra.

84. Mr. Subrata Roy Chowdhry, op.cit., at p.282, also wants this decision to be confined to the particular facts of this case on the ground that "it is conceivable that in appropriate cases the refusal to declare dividends may amount to a method of squeezing out the minority and thereby result in an act of oppression"

Discussing this decision, S.Bhattacharya expresses the opinion: "It is pertinent to ask in this connection

Their Lordships further held that the facts here did not show a continuous process of "oppression" if at all they could be called "oppressive", and also were not sufficient for winding up the company under the "just and equitable" rule. As both these requirements must be necessarily present before a relief under section 397 could be granted, their Lordships refused to allow the petition under section 397.

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84. contd........

as to whether a different view is not possible in a case falling under section 104 of the Income Tax Act, 1961 whereby a company is liable to pay additional supertax unless it declares a minimum amount of dividends prescribed under that section. If in a particular case the directors do not declare a sufficient amount of dividends and thereby there is a liability to additional supertax, can it be urged by any member in an application under section 397 that the conduct of the company's affairs is prejudicial to the interest of the members or some of the members or the Company? Perhaps it is arguable in a case like this that if a member can establish that the non-declaration of sufficient dividends was totally unwarranted, and that the company was unnecessarily made liable to pay additional super-tax which could have been avoided without any deteriment to the company's interest, his petition under section 397 may be tenable. But it must be noted that the onus in such a case will lie very heavily on the member which it will not be, by any means, easy to discharge". See his article, "Provisions Regarding Minority Shareholders Under the Companies Act", published in Proceedings of the Company Law Seminar, Company Law Series, Pamphlet No. 11, at p. 23. This Pamphlet was published in 1964 by the Association of Company Secretaries & Executives, Calcutta-7.

Commenting on this Pamphlet, a review appearing in (1964) 2 Comp. L.J. 82 says at p.83: "But is it not pertinent to ask, a shareholder puts his money in the company not for the fun of it but in order that it may

In *In re Thakur Hotel (Simla) Company Private Ltd.*,[85] the complaint of the petitioners was that the respondents being in majority were riding rough-shod over the rights of the petitioners who were in minority of 24 per cent. No dividends had been paid to them and their interests were being deliberately disregarded. It was alleged, that there was an utter lack of probity on the part of the respondents in dealing with the affairs of the company.

The Court refused to grant relief under section 397, as, in its opinion, the petitioners failed to satisfy the two conditions required to be fulfilled for granting relief under this section, namely, that the affairs of the company were being conducted in a manner oppressive to them and further that the facts justified the making of a winding up order on the ground that it was just and equitable that it should be wound up though in the circumstances it would unfairly prejudice them if the company were ordered to be wound up.

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84. contd.......

yield him some return and if the directors adopting a dog in the manager policy deprive of his expectations, is this not a departure from that fair dealing which a shareholders is entitled to expect from the directors? . . . . It is questionable however whether such conduct in a single year would attract section 397 which requires the oppression to be continuous and not confined to an isolated instance".

85. (1963) 33 Comp. Cas. 1029, decided by Tek Chand, J., of Punjab High Court.

In Sheth Mohanlal Ganpatram v. Shri Sayaji Jubilee Cotton and Jute Mills Co. Ltd.[86], the company was promoted for the purpose of running a textile mill. The company entered into an adat (commission) agreement with a firm whereby the firm agreed to supply working capital to the company for running the mill and to purchase yarn for the company on a commission basis. The mill run by the company started incurring losses after some years and the machinery of the mill had also become old and absolete. The mill was closed down. Its assets were sold and the adat agreement was terminated. After the sale of the assets was concluded, a minority of shareholders of the company applied to the Court under, inter alia, section 397, alleging that the termination of the adat agreement and sale of the mill were, inter alia, oppressive to the minority and claimed that the sale should be set aside.

The Court refused the relief claimed holding that section 397 could prevent present continuing oppression but could not touch a concluded transaction, as was involved in this case.

In In re Bengal Luxmi Cotton Mills Ltd.[87], an application for various interim reliefs in a company

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86. (1964) 34 Comp. Cas. 777, decided by Bhagwati, J., of the Gujerat High Court on February 18, 1964.

87. (1965) 35 Comp. Cas. 187, decided by B.C. Mitra, J., of the Calcutta High Court on September 22, 1964.

petition under, inter alia, section 397 and its supplementary sections was presented. In this application, though there were prayers for various reliefs, it was particularly pressed that a receiver or special officer of the properties, assets and books of accounts and documents of the company be appointed and that the special officer or receiver be given power to carry on the management of the company until further orders of the Court.

It was argued by the respondents that since relief could not be granted in the main petition under section 397, no order for interim relief in this application should be made, as interim relief is granted only in aid of the relief which could be granted in the main petition. Therefore it became necessary to decide, for the purposes of this application, whether relief could be granted in the main petition.

His Lordship held:

> "In my opinion, a winding up order on the just and equitable ground cannot be made, as there is another remedy available for redress of the grievance relating to the transfer of shares and that remedy has been resorted to. That being the petition, an order for winding up of the company on the just and equitable ground cannot be made and for that reason no order can be made under section 397 of the Act". (88)

For these reasons, no relief was granted on the application for interim relief.

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88. Ibid., at p. 249.

GOVERNMENTAL POWERS TO CURB "OPPRESSION".

Section 408(1) of the Companies Act, 1956, gives to the Central Government the power to appoint not more than two persons to hold office as directors of a company for such period, not exceeding three years on any one occasion, as it may think fit, if the Central Government of its own motion or on the application of not less than one hundred members of the company or of members of the company holding not less than one-tenth of the total voting power therein, is satisfied, after such enquiry as it deems fit to make, that it is necessary to make the appointment or appointments in order to prevent the affairs of the company being conducted, *inter alia*, in a manner which is oppressive to any members of the company.

In lieu of passing an order as aforesaid, the Central Government may, if the company has not availed itself of the option given to it under section 265 (that is, option to company to adopt principle of proportional representation for the appointment of directors), direct the company to amend its articles in the manner provided in that section and make fresh appointments of directors in pursuance of the articles as so amended, within such time as may be specified in that behalf by the Central Government.[89]

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89. See proviso to s.408(1), Companies Act, 1956.

In case the Central Government passes an order directing the company to include in its articles provisions for appointment of directors by the principle of proportional representation, the Central Government may, if it thinks fit, direct that until new directors are appointed in pursuance of the aforesaid order, not more than two persons specified by the Central Government shall hold office as additional directors of the company.[90]

A person thus appointed as a director or directed to hold office as an additional director, shall not be required to hold any qualification shares, nor shall his period of office be liable to determination by retirement of directors by rotation.[91] Further, no change in the Board of directors made after a person is appointed a director or directed to hold office as an additional director under the above-given provisions shall, so long as such director or additional director holds office, have effect unless confirmed by the Central Government.[92]

Moreover, the Central Government may, on the application of members,[93] appoint one or more competent

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90. See ibid., section 408(2).
91. See ibid., section 408(4).
92. See ibid., section 408(5).
93. The members entitled to apply should be either not less than two hundred members or members holding not less than one-tenth of the total voting power in the company. In the case of a company not having share capital, the members entitled to apply should be not less than one-fifth of the total number of members of the company. See section 235(a) & (b), Companies Act, 1956.

persons as inspectors to investigate the affairs of the company and to report thereon in such manner as the Central Government may direct.[94] This application should show some good reason[95] for requiring the investigation, and the reason, possibly, may be that the affairs of the company are being conducted in a manner oppressive to any of its members.

Without prejudice to its powers under the last foregoing provisions, the Central Government may appoint one or more competent persons as inspectors to investigate the affairs of the company and to report thereon in such manner as the Central Government may direct if, in its opinion, there are circumstances suggesting that the business of the company is being conducted, *inter alia*, in a manner oppressive of any of its members.[96]

If any such company is liable to be wound up under the Companies Act, 1956, and it appears to the Central Government from the report required to be submitted by the inspector under the last foregoing provision that it is expedient so to do, the Central Government may, unless the company is already being wound up by the court, cause to be presented to the court, by any person authorised by the Central Government in this behalf, (a) a petition for

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94. See *ibid.*, section 235.
95. See *ibid.*, section 236.
96. See *ibid.*, section 237(b)(i).

the winding up of the company on the ground that it is just and equitable that it should be wound up, or (b) an application for an order, <u>inter alia</u>, under section 397, or (c) both a petition and an application as aforesaid.[97]

<u>CONCLUSIONS AND SUGGESTIONS</u>

Section 397 and its supplementary sections are an innovation in our company law introduced between 1951 and 1956. They were introduced in order to supress an acknowledged mischief. But it is clear from the preceding discussion of cases that section 397 could not prove to be an infallible source of relief to the oppressed minority. It is also clear that this is so to a great extent because of two reasons. The first reason is the requirement of this section that a single act of oppression is not sufficient, and what is required is a continuous process of oppression. The second reason is again the requirement of this section that the facts must be such which would justify a winding up order under the "just and equitable" rule.

It is humbly suggested that we should do away[98] with both these requirements which obstruct the working of

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97. See <u>ibid</u>., section 243.
98. The Jenkins Committee Report, 1962, cmnd. 1749 recommended the deletion of both these requirements from s.210 of the English Act, and also some thing more. See para 212 of this Report and also note 34, <u>supra</u>. Mr. Justice P.N. Bhagwati also recommended the same thing in regard to s.397. Mr. Subrata Roy

the gracious holder of scales between the majority and the minority, which the court[99] under section 397 has been contemplated to be. If both these restrictions are done away with, the Indian Parliament would be giving much wider powers to courts. But large powers on the statute-book alone will not be sufficient. In order to make the powers really deterrent to unscrupulous majorities, the courts will be required to interpret these provisions in the spirit in which the House of Lords in England

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98. contd.......
Chowdhry recommended abolition of the "continuous process" requirement but wanted retention of the "just and equitable to wind up" requirement with a "progressive tendency to expand its core". See <u>Proceedings of the Seminar on Current Problems of Corporate Law, Management and Practice</u>, pp. 74-77.

Dr.Schmitthoff considers the same requirements of s. 210 as unduly restrictive and recommends that the reform of company law should relax "these restrictions and expand the remedy into a general provision enabling the court to give relief on the application of an individual shareholder who proves oppression, unfair treatment, misconduct in connection with the affairs of the company or failure to give the shareholders all the information which they might reasonably expect; the court should have general jurisdiction, if any of these matters is proved, to give relief when of opinion that it is just and equitable to do so". See his article "The Implications of Company Law Reform", (1960) J.Bus.L. 151 at p. 157.

99. This power of the court is now to be exercised in the first instance by a Tribunal constituted under the Companies (Amendment) Act, No. 53 of 1963. But since there is provision for appeal to the courts on questions of law against the decisions of this Tribunal (see section 10D of the Companies Act, 1956), the power under section 397 ultimately resides, even now, in the courts.

interpreted section 210[100] (with all its restrictive provisions intact) of the (English) Companies Act, 1948, in the famous case of Scottish Co-operative Wholesale Society Ltd. v. Meyer.[101] This decision has been rightly

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100. For relevant clauses of section 210, see note 27, *supra*.

101. (1958) 3 W.L.R. 404, referred to *supra* under the heading, "Meaning of Oppression".

This case was as follows. The appellants, owners of a weaving mill, and the respondents, who formerly were German nationals, started in 1947 the manufacture of rayon cloth, which the appellants had not previously manufactured. The respondents, who provided the formulas, knowledge and experience, had extensive connections in Europe in the trade and obtained licences for the purchase of yarn and the manufacture of rayon cloth, which was then subject to control. A private company, a subsidiary of the appellants, was formed for the purpose. The issued share capital of this company, a subsidiary of the appellants, was formed for the purpose. The issued share capital of this company was 7,900 £ 1 shares, of which 4000 shares were held by the appellants and 3,900 shares by the respondents. The company had five directors of whom the respondents were two and three were nominees, and directors, of the appellants. The respondents obtained supplies of yarn, for which the appellants paid, and the cloth was woven and processed at the appellants' mill and was then sold to the company ready for dyeing and finishing. The cloth after these operations was sold by the company. The company earned good profits. The appellants desired to acquire further shares at par, the value of a £ 1 share being then £ 6. The respondents did not agree and from that time hostility on the part of the appellants and their nominees on the board of the company to the respondents developed.

In or about June, 1951, the appellants formed a new department called the merchant converting department Its function was to convert loom state cloth by dyeing, printing and finishing into material fit for sale. That is, the function of this department was the same which the company was performing. After the end of cotton control in June, 1952, the appellants were free

called the most valuable contribution which the House of Lords has made to judicial reform of Company law in England.[102] This is because it gave unqualified support to the intention of the British Parliament to prevent oppression. This case, although a clear attempt at a "squeeze-out" of the minority, was not easy to bring within the four corners of section 210,

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101. contd........

to obtain yarn, without licence. They then adopted a policy of starving the company of supply of rayon cloth from their mill, knowing that the company depends on this supply. Early in 1953 the board of the appellants refused an offer of the respondents to sell their shares at a negotiated price (about £ 4 16 s. per share), recording in their minutes that the company had served its purpose and should be liquidated, if possible. Three directors of the company who were nominees of the appellants, adopted a policy of passive support of the appellants by inactivity, allowing the company's trading activities to head towards extinction. In 1953 the respondents presented a petition under section 210, on the ground that the affairs of the company were being conducted in a manner oppressive to themselves. The First Division of the Scottish Court of Session held that there was oppression and ordered the appellants to purchase the respondents' shares at £ 3 15 s.each.

On appeal, the House of Lords held that the conduct of the appellants was oppressive and, in view of the facts that the company was a subsidiary of the appellants and that the appellants' nominees on the board of the company were participating in the policy of the appellants, was also oppressive conduct of the affairs of the company within section 210, although the misconduct of the nominee directors was negative, being passive neglect of the company's interests. The appeal was dismissed.

102. See Dr. Schmitthoff, "Judicial Reform of Company Law in the United Kingdom", (1962) Malaya L.Rev. 76, at pp. 77-78.

and there was ample opportunity for the House of Lords to adopt a restrictive interpretation of that section on narrow, legalistic grounds.[103] The House of Lords did nothing of that kind but unanimously adopted a wide interpretation as a matter of deliberate judicial policy.[104]

It is to be hoped that our courts also, in suitable cases that may come before them, will show similar judicial disposition and will impose efficacious curbs on abuses of authority by overbearing majorities.

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103. See *ibid.*

104. Speaking about section 210, Viscount Simonds observed: "If this section is inept to cover, such a case, it will be a dead letter indeed. I have expressed myself strongly in this case because it appears to me to be a glaring example of precisely the evil which Parliament intended to remedy" - see (1958) 3 W.L.R. 404, at p. 411.

CHAPTER 2

OTHER ABUSES OF AUTHORITY AND RELIEFS AGAINST THEM

In the last Chapter we have discussed the abuse of authority by majority shareholders which hits the minority alone. The aim of this chapter is to discuss abuses of authority of other varieties. The other varieties are (1) abuse of authority which hits the company as a whole, and (2) abuse of authority which hits the public interest.[1]

Taking up in the first place, the abuse of authority which hits the company as a whole, it may be said here that the majority have the authority to administer the affairs of a company, but in doing so, they must see that they do not conduct the affairs of the company in a manner prejudicial to its interests. In other words, the majority have the authority to manage the affairs of a company but not to mismanage them. If they mismanage, it is clearly abuse of authority.

But the remedy for this abuse, apart from two types of exceptional cases,[2] was until 1950[3] with the

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1. See introduction to this Part (Part III) and note 4 thereof.
2. See texts to notes 48 and 35, *infra*.
3. In England, apart from the same two types of exceptional cases, it is even now with the company and not with a minority of shareholders. See text to note 35, *infra*.

company alone. The minority shareholders did not have the power to bring a suit for remedying this abuse. The well-known English rule of Foss v. Harbottle[4] stood in their way.

POSITION IN ENGLAND

What happened in Foss v. Harbottle was, that a bill was filed by two shareholders of a company which was incorporated by an Act of Parliament. It was on behalf of themselves and all other shareholders, except the defendants, against the five directors (three of whom had become bankrupt), and against a shareholder who was not a director, and the solicitor and architect of the company. This bill charged the defendants with concerting and effecting various fraudulent and illegal transactions, whereby the property of the company was misapplied, alienated and wasted. They also alleged that there had ceased to be a sufficient number of qualified directors to constitute a board; that the company had no clerk or office; that in such circumstances the shareholders had no power to take the property out of the hands of the defendants, or satisfy the liabilities or wind up the affairs of the company.

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4. (1843) 2 Hare, 461; 67 Eng. Rep. 189.

It was prayed that the defendants might be decreed to make good to the company the losses and expenses occasioned by the acts complained of; and further that a receiver should be appointed to take charge and apply the property of the company in discharge of its liabilities, and secure the surplus. The defendants objected.

Vice-Chancellor, Sir James Wigram, allowing the objections, held that, upon the facts stated, the possibility of convening a general meeting of shareholders capable of controlling the acts of the existing board was not excluded by the allegations in the bill; that in such circumstances there was nothing to prevent the company from obtaining redress in its corporate character in respect of the matters complained of; and that therefore the plaintiffs could not sue in a form of pleading which assumed the practical dissolution of the corporation. For these reasons, the bill was dismissed.

This case has been explained and approved in a large number of subsequent cases.[5] The following statement of Lord Davey in _Burland_ v. _Earle_[6] became a starting point, as also a touchstone, for all subsequent cases on the point:

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5. For example, see _Mosley_ v. _Alston_, (1847) 1 Ph. 790; _Gray_ v. _Lewis_, (1873) 8 Ch. App. 1035; and _MacDougall_ v. _Gardiner_, (1876) 1 Ch. D. 13. For brief details about these cases collected at one place, please see Jagdish Swarup, _The Companies Act, 1956_, Vol. I, at pp. 115-116.

6. (1902) A.C. 83.

"It is an elementary principle of the law relating to joint stock companies that the court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so. Again, it is clear law that in order to redress a wrong done to the company or to recover moneys or damages alleged to be due to the company, the action should prima facie be brought by the company itself. These cardinal principles are laid down in the well-known cases of Foss v. Harbottle (7) and Mozley v. Alston (8), and in numerous later cases which it is unnecessary to cite. But an exception is made to the second rule, where the persons against whom the relief is sought themselves hold and control the majority of the shares in the company, and will not permit an action to be brought in the name of the company.

In that case the courts allow the shareholders complaining to bring an action in their own names. This, however, is mere matter of procedure in order to give a remedy for a wrong which would otherwise escape redress, and it is obvious that in such an action the plaintiffs cannot have a larger right to relief than the company itself would have if it were plaintiff, and cannot complain of acts which are valid if done with the approval of the majority of the shareholders, or are capable of being confirmed by the majority. The cases in which the minority can maintain such an action are, therefore, confined to those in which the acts complained of are of a fraudulent character or beyond the powers of the company. A familiar example is where the majority are endeavouring directly or indirectly to appropriate to themselves money, property, or advantages which belong to the company, or in which the other shareholders are entitled to participate, as was alleged in the case of Menier v. Hooper's Telegraph Works (9)". (10)

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7. (1843) 2 Hare 461.

8. (1847) 1 Ph. 790.

9. (1874) L.R. 9 Ch. 350.

10. (1902) A.C. 83, at p. 93.

This classical statement describes distinctly the two principles which are jointly known as the rule in *Foss* v. *Harbottle*,[11] namely, (1) the court has no jurisdiction to interfere with the internal management of companies acting within their powers, and (2) in order to redress a wrong done to the company or to recover moneys or damages alleged to be due to the company, the action should *prima facie* be brought by the company itself.[12] The first part of this rule has been discussed in the last chapter.[13] Here, we shall now be discussing the second part of this rule.

To the rule that in order to redress a wrong done to the company or to recover moneys or damages alleged to be due to the company, the action should *prima facie* be brought by the company itself, the above-given statement of Lord Devey itself recognises two exceptions. They are (1) cases in which the acts complained of are of a fraudulent character (in which his Lordship included appropriation of money, property, or advantages, by a majority in fraud of the minority), and (2) cases in which the acts complained

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11. (1843) 2 Hare 461.

12. The first principle is understood as resulting from extension to companies of a partnership doctrine that the courts were averse to interfering at all between one partner and another, unless it was for the purpose of dissolving the partnership. The second principle is understood as springing from the treatment in law of a corporation as a "person" separate from the members of which it is composed. See K.W. Wedderburn, "Shareholders' Rights and the Rule in *Foss* v. *Harbottle*", (1957) Camb. L.J. 194, at pp. 196-197.

13. See note 2 and its text in the last Chapter.

of are beyond the powers of the company. To these two, another exception is also, not very unoften, added, namely, (3) cases where there is an absolute necessity to waive the rule in order that there may not be a denial of justice.[14]

This third exception, Wigram, V.C., recognised himself, in Foss v. Harbottle, when his Lordship observed:

> "If a case should arise of injury to a corporation by some of its members, for which no adequate remedy remained, except that of a suit by individual corporators in their private characters, and asking in such character the protection of those rights to which in their corporate character they were entitled, I cannot but think that . . . the claims of justice would be found superior to any difficulties arising out of technical rules respecting the mode in which corporations are required to sue". (15)

But Justice Danckwerts doubted the existence of this exception in Pavlides v. Jensen,[16] wherein his Lordship

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14. See Palmer's Company Precedents, Part I, at pp. 1098-1099 (17th ed. 1956); Buckley on the Companies Acts, at pp. 170-171 (13th ed. 1957); and Jagdish Swarup, The Companies Act, 1956, Vol. I at p. 114.

    Speaking of the rule in Foss v. Harbottle, Sir George Jessel, M.R., said in Russel v. Wakefield Waterworks Co.: "that is not a universal rule; that is, it is a rule subject to exceptions, and the exceptions depend very much on the necessity of the case; that is, the necessity for the court doing justice". And further: "As I have said before, the rule is a general one, but it does not apply to a case where the interests of justice require the rule to be dispensed with". See (1875) L.R. 20 Eq. 474, at pp. 480 and 482. Emphasis added.

    See also Satyavrat v. Arya Samaj, (1946) A.I.R. Bom. 516, at p. 525, Col. 1.

15. (1843) 2 Hare 461, at p. 492. Emphasis added.

16. (1956) Ch. D. 565. His Lordship said at p. 576: "On

refused to entertain a minority shareholders' representative action demanding damages for gross negligence, on the ground that the action did not fall within the two (namely, fraud and ultra vires) exceptions of the rule in Foss v. Harbottle.[17] In the recent case of Heyting v. Dupont,[18] Justice Plowman refused to entertain a minority shareholder's representative action against a director and the company of damages for the defendant's misfeasances and breaches of trust as a director. The misfeasance alleged was that the defendant director was responsible for the delay in the exploitation of the invention for the benefit of the company and for the consequent loss to the company on account of the lost opportunities. The breach of trust

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16. contd.........
the facts of the present case, the sale of the company's mine was not beyond the powers of the company, and it is not alleged to be ultra vires. There is no allegation of fraud on the part of the directors or appropriation of assets of the company by the majority shareholders in fraud of the minority. It was open to the company, on the resolution of a majority of the shareholders, to sell the mine at a price decided by the company in that manner, and it was open to the company by vote of the majority to decide that, if the directors by their negligence or error of judgment had sold the company's mine at an undervalue, proceedings should not be taken by the company against the directors. Applying, therefore, the principles as stated by Lord Davey, it is impossible to see how the present action can be maintained". It is not clear how the majority by means of a resolution could absolve directors from consequences of their negligence in view of section 205 of the (English) Companies Act, 1948. See also note 21 of Chapter 2 of Part I of this thesis.

17. (1843) 2 Hare 461.

18. (1963) 1 W.L.R. 1192. Some of the comments which this decision evoked from a learned author who has produced

on account of the lost opportunities. The breach of trust alleged was that the defendant director wrongfully and without proper authority from the company drew upon the company's bank account a cheque which cheque he cashed and thereafter retained the said cash and applied the same for his own purposes. The ground for refusal to entertain this action was stated by his Lordship to be that the statement of claim contained no allegation of _ultra vires_, or of fraud or of any material appropriation of assets in fraud of the minority.

On appeal, the Court of Appeal, while admitting the possibility of recognising an exception on the ground of misfeasance without alleging fraud or _ultra vires_, nevertheless, held that the misfeasance relied upon must have caused real damage to the company and since in the present case it was plain on the pleadings that the company was in such a state of paralysis that it could not have

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18. contd........

good deal of literature on the rule in _Foss_ v. _Harbottle_, for which literature please see (1957) Camb. L.J. 194 and (1958) Camb. L.J. 93 — were: "The first lesson in _Heyting_ v. _Dupont_ (1963) 1 W.L.R. 1192, is that the Rule in _Foss_ v. _Harbottle_ (1843) 2 Hare 461, is still very much alive"; and "Until such reforms are given effect to by legislation, however, the attitude in _Heyting_ v. _Dupont_ may be thought, with respect, to be rather unnecessarily narrow in its approach both to the policy and to the black letter precedent of the Rule in _Foss_ v. _Harbottle_". See K.W. Wedderburn in (1964) Camb. L.J. at pp. 39 and 43.

successfully exploited the invention, it had suffered no such damage, and, therefore the action failed in limine.[19] Rightly enought, this small encouragement towards the possibility of recognising a new exception on grounds of demands of justice, has been noticed with interest in respectable quarters.[20]

The Jenkins Committee also showed its anxiety about indirect wrongs to the minority by which it meant "the type of case in which a wrong is done to the company itself and the control vested in the majority is wrongfully used to prevent action being taken against the wrongdoer. In such a case the minority is indirectly wronged".[21] In the Committee's opinion, because of the rule in Foss v. Harbottle,[22] the wronged minority shareholder could sue for remedying the wrong, (1) if the act complained of is ultra vires or illegal, or (2) "if, but only if, (a) the wrong alleged to have been done to the company is of a fraudulent character; and (b) he can show that the control vested in the majority is being, or will be, used to prevent

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19. Hevting v. Dupont, (1964) 1 W.L.R. 843, decided by Harman, Davies and Russell, L. JJ.

20. See K.W. Wedderburn in (1964) Camb. L.J. 213 at pp. 213-214. Also see (1964) 38 Austl.L.J. 286 at p. 287.

21. See Report of the Company Law Committee, Cmnd. 1749, at p. 76 (1962).

22. (1843) 2 Hare 461.

the company from suing in such a way as to constitute a 'fraud on the minority'."[23] The Committee agreed with the representations made to it to the effect that conditions (a) and (b), given above, were too restrictive, "since the company's omission to sue may be unfair to the minority even if the wrong done to the company is not fraudulent and since the plaintiff may find it very difficult to prove both that the defendants control the company and that there is a 'fraud on the minority' — a notoriously vague concept".[24] But the Committee thought that "it would be extremely difficult to devise a satisfactory general provision expressing the exception to the rule in Foss v. Harbottle in wider terms".[25]

Still the Committee thought that if the proposal made by them at paragraph 204[26] (which proposal was to amend section 210[27] so as to make it clear, (1) that the terms "oppréssive" also covered acts unfairly prejudicial[28] to the interests of the complaining members, and (2) that

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23. See Report of the Company Law Committee, at p. 76.
24. Ibid.
25. Ibid.
26. In this connection, see also note 34 of the last Chapter.
27. For this section, see note 27 of the last Chapter.
28. That is, the Jenkins Committee recommended, that the term "oppressive" should not be confined to its narrower sense but should be given broader meaning so as also to cover acts unfairly prejudicial to the interests of the minority shareholders.

section 210 applied to particular acts,[29] which are oppressive to or unfairly prejudice the interests of the complaining members, as well as to courses of conduct having those effects) was accepted, and section 210 amended accordingly, "it should go some way to providing a shareholder who suffers an indirect wrong of the kind described above with a more effective remedy than he enjoys at common law".[30] In this connection, the Committee also thought that "for this purpose section 210 should be further extended to give the court x an express power, if upon hearing a petition under that section it sees fit, to authorize proceedings to be brought against a third party in the name of the company by such person or persons and on such terms as the court may direct".[31]

It was suggested to the Committee that there might be a danger in extending the courses of action open to a minority shareholder in this way. One of the American witnesses before the Committee, Mr. G.A. Brownell, admitted that they had been abused in the United States. He nevertheless expressed the opinion that "I believe it is

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29. Till now, it applies on to courses of conduct and not to particular isolated acts of oppression.

30. See <u>Report of the Company Law Committee</u>, at p. 76.

31. <u>Ibid</u>. But the Committee made it clear that the power thus given to the court should be without prejudice to the powers of the Board of Trade under section 165(b) (i) to appoint an inspector where it appeared to the Board that there were circumstances suggesting that the business of a company was being carried on in a manner oppressive of any part of its members.

correct and wise that minority stockholder's actions can be brought on behalf of the corporation against the directors, not only in cases of fraud but in cases of negligence, waste of corporate assets and so forth. Generally speaking, the right of stockholders to bring actions in such cases has a good effect in our corporate law, despite the fact that it often is abused".[32] Replying to the critics, the Committee retorted that, by making these recommendations, it was never their intention to encourage litigation in cases in which, for instance, an independent majority had reached a bona fide decision to the effect that in the interests of the company as a whole no action should be taken. In fact, the Committee thought that probable liability for costs of an unsuccessful litigant would "be sufficient safeguards against abuse".[33]

The preceding discussion of English cases, particularly of the Court of Appeal judgment in Heyting v. Dupont,[34] and of the recommendations of the Jenkins Committee, shows an increasing desire in England to give to the minority a right to sue for remedying what the Jenkins Committee called an indirect wrong to them or, what

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32. Opinion of Mr. G.A. Brownell, quoted in Report of the Company Law Committee, at p. 77.

33. Ibid.

34. (1964) 1 W.L.R. 843.

can be called in other words, an abuse of majority's authority which hits the company as a whole. But the present position is also that, apart from two exceptional type of cases, namely, (1) ultra vires, and (2) fraud of the variety referred to in Jenkins Committee Report, the minority do not have this right.[35]

POSITION IN THE UNITED STATES OF AMERICA

But this right is given to the minority in the United States where the minority exercises this right by bringing what are known as derivative suits.[36] Explaining

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35. See note 3, supra.

36. Stating the background of derivative suits, Mr. Justice Jackson of the U.S. Supreme Court observed: "As business enterprise increasingly sought the advantages of incorporation, management became vested with almost uncontrolled discretion in handling other people's money. The vast aggregate of funds committed to corporate control came to be drawn to a considerable extent from numerous and scattered holders of small interests. The director was not subject to an effective accountability. That created strong temptation for managers to profit personally at expense of their trust. The business code became all too tolerant of such practices. Corporate laws were lax and were not self-enforcing, and stockholders, in face of gravest abuses, were singularly impotent in obtaining redress of abuses of trust. Equity came to the relief of the stockholders, who had no standing to bring civil action at law against faithless directors and managers. Equity, however, allowed him to step into the corporation's shoes and to seek in its right the restitution he could not demand in his own. It required him first to demand that the corporation vindicate its own rights but when, as was usual, those who perpetrated the wrongs also were able to obstruct any remedy, equity would hear and adjudge the corporation's cause through its stockholder with the corporation as a defendant, albeit a rather nominal one. This remedy born of

the rationale of derivative suits, an American treatise very aptly says:

> "If the duties of care and loyalty which directors owe to their corporations could be enforced only in suits by the corporation, many wrongs done by directors would never be remedied. Where the majority of the shareholders benefit by the directors' breach of duty, they will normally continue to elect the same directors or others who can be relied on not to institute litigation designed to remedy the wrong. Even where the shareholders do not benefit by the directors' wrongdoing, the difficulty of so organising the majority shareholders as to cause them to oust the wrongdoing directors from office and to elect new directors who will institute litigation against their predecessors is often insuperable. The minority shareholders' suit is a procedural device designed to facilitate holding wrongdoing directors and majority shareholders to account, and also to enforce corporate claims against third persons. It is obvious that wrongful acts by directors or other managers may result in direct injuries to individual shareholders entitling the latter to sue in their own right and for their own benefit. Of such a character are the wrongful failure to permit a shareholder to vote, and to permit a transfer of shares on the corporation's books. On the other hand, many wrongful acts or omissions of directors or other managers injure the shareholders only indirectly through depleting the corporate assets or using them in a manner contrary to the provisions of the articles of incorporation. <u>Shareholders' derivative suits are concerned with this latter type of wrong</u>". (37)

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36. contd........
stockholder helplessness was long the chief regulator or corporate management and has afforded no small incentive to avoid at least grosser forms of betrayal of stockholders' interests. It is argued, and not without reason, that without it there would be little practical check on such abuses". See <u>Cohen v. Beneficial Industrial Loan Corp.</u>, 337 U.S. 541 at pp. 547-548; 93 L.ed. 1528, at p. 1537 (1948).

37. Baker and Cary, <u>Cases and Materials on Corporations</u>, at p. 627 (3rd ed.1958). Emphasis added.

This right of the minority is treated to be so important that even the fact that the plaintiff has not paid his stock subscription, can be no defence to a derivative action by him against his corporation and its directors on the ground of the directors' mismanagement.[38] Further, the smallness of corporate holdings of the stockholder bringing a derivative suit has been held to be irrelevant.[39]

However, a demand on the corporation to bring action for the wrong or negligence of directors, followed by a failure or refusal to act, is necessary to authorise a stockholders' derivative action. As regards what mode of demand may amount to a legal request to a corporation, some cases state that demand may be made on the officers while others state that it may be made on the majority stockholders. The ordinary method seems to be to make the demand upon the directors.[40] But this requirement of making a demand may be dispensed with if the facts show that a demand would be futile. Thus, stockholders may bring a derivative action without making a demand where the defendants have acquired control of the corporation by conspiracy, substituted themselves as directors, and

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38. See Oleck, Modern Corporation Law, Vol.3, at p. 669. (1959).

39. See ibid.

40. See ibid., at p. 671.

diverted its assets.[41] So also, demand was not a condition precedent to minority stockholders' suit for fraud against a director where the majority stockholders and directors were in sympathy with such director.[42]

This right of the minority stockholder to bring a derivative suit is made further easy of enforcement by two practices. In the United States, a lawyer can take a case on a contingent basis, that is, sharing in the amount of the judgment only if the plaintiff wins. In a shareholders' derivative action, the plaintiff's lawyer seldom takes an advance fee. If there is any recovery, the counsel petitions the court to award him a fee out of the amount recovered, and the court rewards him liberally. Secondly, unlike the Indian or the British systems where the loser generally pays the winner's costs, including the counsel's fee awarded by the court, American courts have never considered that they had this power at common law. They award costs but not including counsel fees except under some statutes, notably the S.E.C. statutes, which make special provision. Therefore, when a minority shareholder brings an action and loses, not only does he not pay his own lawyer, but he does not even risk having to

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41. See ibid., at pp. 671-672.

42. See ibid., at p. 672.

pay the defendant's lawyer.[43]

Human nature being what it is, the more easily enforceable a right is, the greater is the likelihood of its being abused. This is exactly what happened in the United States. Taking advantage or rather undue advantage of these very helpful conditions, some stockholders inflicted extortionate litigation on corporations by piratical suits prosecuted for no other than hold-up purposes by "professional privateers". These suits came to be known as "strike suits". A "strike suit" has been defined as "an action brought purely for its nuisance value, with the purpose of obtaining a settlement for the

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43. See speech of Professor Loss (from U.S.A.) in Proceedings of the Seminar on Current Problems of Corporate Law, Management and Practice, at p. 81 (1964).

Speaking of derivative suits in England, Prof. Gower says: "In England, however, derivative actions are relatively uncommon and undeveloped. Indeed, the expression 'derivative action' is unknown and stockholders' suits are treated as if they were ordinary representative actions, which of course they are not. Theoretically such an action seems to be available to minority stockholders rather more readily than in America. There is not, for example, any rule, such as that prevailing in most American states and under the Federal Rules of Civil Procedure, that the stockholders must first serve a demand for action on the directors and, sometimes, on the other stockholders also. On the other hand the old rule in Foss v. Harbottle, from which the American practice seems to be derived, still survives in England and bars a stockholder's suit if the action complained of is one which could be effectively remedied by a vote of a simple majority at a general meeting. But whatever the theory may be, in practice such actions are rare, and England has not been faced with the problem of strike suits and has not had to enact special

complainant's sole benefit, — the amount of the proposed settlement being far greater than any possible injury suffered by the complainant".[44] Because of this abuse, some jurisdictions like New York, New Jersey, Maryland, Pennsylvania and California have put some minor restrictions on the maintenance of derivative suits by very small stockholders.[45]

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43. contd........
legislation to curb this abuse. This is because of the general English rule that the loser pays the costs, including the winner's advocate's fees, and because it is unprofessional for a lawyer to take a case on a contingent fee. Any litigation, and especially the more fancy type, is therefore an unattractive gamble. Hence minority stockholwers are rarely willing to embark on litigation against directors who are backed by the company's resources. Normally it is only if the company goes into liquidation that the directors are made to answer for their misdeeds, for then the Companies Act affords the liquidator a summary remedy. The English problem has been that while the company remains a going concern the stockholder's suit is not an effective sanction". See his article, "Some Contrasts between Bitiwh and American Corporation Law", 69 Harv. L.R. 1369 at pp. 1385-1386 (1956).

44. See Ballantine on Corporations, at p. 356 (rev.ed.1946).

45. For example, New York General Corporation Law, section 61-b lays down that in any action instituted or maintained in the right of any foreign or domestic corporation by the holder or holders of less than five per cent. of the outstanding shares of any class of such corporation's stock or voting trust certificates, unless the share or voting trust certificates held by such holder or holders have a market value in excess of 50,000 dollars, the corporation in whose right such action is brought shall be entitled at any stage of the proceedings before final judgment to require the plaintiff or plaintiffs to give security for the reasonable expenses, including attorney's fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith

But despite the abuses, the derivative suits are considered in the United States as the minority shareholders' only effective remedy for attacking abuses of managerial power. A federal district court Judge spoke thus about the usefulness of these suits:

> "Despite the numerous abuses which have developed in connection with such suits, they have accomplished much in policing the corporate system, especially in protecting corporate ownership as against corporate management. They have educated corporate directors in the principles of fiduciary responsibility and undivided loyalty. They have encouraged the wisdom of full disclosure to stockholders . . . . The minatory effect of such actions has undoubtedly prevented the diversion of large amounts from stockholders to managements and outsiders". (46)

THE POSITION IN INDIA

The position of law in this regard in India before 1951 was exactly the same as it prevails in England under the Rule in *Foss* v. *Harbottle*,[47] as discussed above.[48] But

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45. contd.....
for which it may become subject pursuant to section 64 of the instant chapter (which deals with Assessment of Expenses), to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter from time to time be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive.

46. Rifkind, D.J., in *Brendle* v. *Smith*, 46 Fed. Supp. 822, 825 (D.C.N.Y.), quoted in Ballantine, Corporations, at p. 356 (rev. ed. 1946).

47. (1843) 2 Hare 461.

48. See text to note 38, *supra*.

in that year the Indian Parliament made a departure from the English position by adding two new sections, namely 153C and 153D to the Indian Companies Act, 1913 by an Amending Act of 1951. Relevant portions of section 153C were as follows:

<u>Alternative Remedy to Winding up in cases of mismanagement...</u>

153C. Power of court to act when company acts in a prejudicial manner . . . —

(1) Without prejudice to any other action that may be taken, whether in pursuance of this act or any other law for the time being in force, any member of a company who complains that the affairs of the company are being conducted —

(a) in a manner prejudicial to the interest of the company,

(b) . . . may make an application to the court for an order under this section,

(2) An application under sub-section (1) may also be made by the Central Government if it is satisfied that the affairs of the company are being conducted as aforesaid.

(4) If on any such application the court is of opinion —

(a) that the company's affairs are being conducted as aforesaid, and

(b) that to wind up the company would unfairly and materially prejudice the interests of the company or any part of its members, but otherwise the facts would justify the making of a winding up order on the ground that it is just and equitable that the company should be wound up, the court may, with a view to bringing to an end the matters complained of, make such order in relation thereto as it thinks fit.

Some other parts of this section and section 153D elaborated the principle embodied in the parts quoted above and also laid down some qualifications for obtaining relief under these provisions.

Thus by giving to the court the power to "make such order in relation thereto as it thinks fit" with a view to bringing to an end the conduct of affairs of a company in a manner prejudicial to its interests, the Indian Parliament took a big step forward towards curbing that abuse of the majority's authority which hits the company as a whole and which is at present under discussion.

When the Indian Companies Act, 1913, was replaced by the Companies Act, 1956, the provisions of sections 153C and 153D were elaborated into 11 sections, namely, sections 397 to 407 of Chapter VI (Part VI); the remaining two sections of that Chapter, namely, sections 408 and 409 conferring powers upon the Central Government to prevent, _inter alia_, the affairs of the company being conducted in a manner prejudicial to its interests, being innovations of the 1956 Act. Relevant provisions of section 153C, quoted above, became the basis of section 398 and part of section 401. Section 398 now[49] is as follows:

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49. The words within double brackets have been added to section 398 by the Companies (Amendment) Act, No. 53 of 1963. The addition of these words to section 398, has the effect of expressly declaring it to be an abuse of the majority's authority to conduct the affairs

398. <u>Application to Court for relief in cases of mismanagement</u> —

(1) Any members of a company who complain —

(a) that the affairs of the company are being conducted ((in a manner prejudicial to public interest or)) in a manner prejudicial to the interests of the company; or

(b) that a material change (not being a change brought about by, or in the interests of, any creditors including debenture holders, or any class of shareholders of the company) has taken place in the management or control of the company, whether by an alteration in its Board of directors, or of its managing agent or secretaries and treasurers or manager, or in the constitution or in the control of the firm or body corporate acting as its managing agent or secretaries and treasurers, or in the ownership of the company's shares, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted ((in a manner prejudicial to public interest or)) in a manner prejudicial to the interests of the company; may apply to the court for an order under this section, provided such members have a right so to apply in virtue of section 399.

(2) If, on any application under sub-section (1), the court is of the opinion that the affairs of the company are being conducted as aforesaid or that by reason of any material change as aforesaid in the management or control of the company

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49. contd........
of a company prejudicially to public interest, i.e., it being abuse of the second of the two varieties with which this chapter deals. See text to note 1, *supra*.

> it is likely that the affairs of the company will be conducted as aforesaid, the court may, with a view to bringing to an end or preventing the matters complained of or apprehended, make such order as it thinks fit". (50)

As will appear by carefully reading the relevant provisions of section 153C, quoted above, and the provisions of section 398, just quoted, one significant departure which section 398 makes from section 153C, is the doing away in the former section with the requirement of making out a case for winding up of the company, which requirement section 153C had made a necessary condition for granting relief. This was done at the recommendation of the Bhabha Committee

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50. This section has no corresponding section in the (English) Companies Act, 1948. The Company Law Committee in India, popularly known as the Bhabha Committee, in its Report submitted in 1952, speaking about section 210 of the (English) Companies Act, 1948, said: "We have carefully examined the scope of this section and consider that not only can it be suitably adapted to the circumstances of this country, but its scope may be appropriately enlarged to cover not only the cases of oppression to a minority of shareholders, but also of gross mismanagement of the affairs of a company _which cannot be otherwise suitably dealt with under the other provisions of the Act_. We accordingly recommend the enactment of two sections:-

    (i) to provide for a remedy for the oppression of minorities on the lines of section 210 of the English Act, 1948; and

    (ii) to provide for a remedy in cases of mismanagement of a company's affairs in a manner prejudicial to the interests of the company". — See _Report of the Company Law Committee, 1952_ at p. 149, end of paragraph 199. Emphasis added.

which considered this requirement as unnecessarily restrictive.[51] This requirement being not there, the only requirements of section 398, for the granting of extensive reliefs under it, are,[52] that the affairs of the company are (1) being conducted in a manner prejudicial to its interests, or (2) are apprehended to be so conducted by reason of a material change in the management or control of the company.

Now the question arises, as to when and in what circumstances are these requirements fulfilled, and, therefore, what are those conditions and circumstances which have been found to be suitable for granting relief under section 398.

CASES IN WHICH RELIEF UNDER SECTION 398 GRANTED

Mostly the petitions presented are composite petitions, asking for relief under section 397 as well as

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51. Speaking about sections 153C and 153D, the Bhabha Committee Report expressed the opinion: ". . . we do not contemplate that shareholders who complain that the affairs of their company are being managed in a manner prejudicial to the interests of the company should be required also to prove that the facts disclose such a state of affairs as would justify the making of a winding-up order". See this Report at p. 151, towards the end of paragraph 202.

52. Leaving out of consideration here the alternative requirement of conducting the affairs of the company in a manner prejudicial to public interest (i.e. abuse of the second variety), an aspect which is to be discussed later in this chapter.

section 398. That composite petitions could be presented was never doubted, and composite petitions were entertained without harbouring any doubt on this score. But in one case,[53] Justice Tambe of the Bombay High Court took the view that separate applications would be necessary and therefore, gave an opportunity to the applicant to file his petition for relief under either of the two sections. But this decision was reversed in appeal,[54] wherein Justice Patel, delivering judgment of division bench, held that there was nothing which went against the maintainability

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53. The petitioner in this case made a composite petition against the company and its directors, alleging that the affairs of the company were so managed as to be prejudicial to the company and also oppressive to the minority shareholders. The respondents made an application that such a composite application could not be made under the Companies Act. They also contended that separate court-fees would be necessary on such applications or prayers and, thirdly, that they would be prejudicially affected at the trial because of these two causes of action joined together in the same application.

54. The appeal judgment appeared as Sorab Dinshaji Dastoor v. D.P.R. cassad, (1963) 1 Comp. L.J. 104. In this case, it was also contended by the respondents that it was difficult for them to clearly understand upon what allegations the petitioner relied for the relief under section 397 and on which allegations he relied for relief under section 398. To this his Lordship replied: "A perusal of this application shows that the applicant made allegations against the management which furnish a cause of action under section 397 as well as under section 398. Really speaking, the application sets out the facts and merely wants the court to draw an inference of oppression as well as mismanagement from the same facts. By asking the applicant to file another application what we will be requiring him to do would be fx to file another copy of the same application and then in one pray

of a composite petition if, as here, the petition made allegations against the management which furnished a cause of action under section 397 as well as under section 398.

Composite petitions being permissible, the result has been that in almost all the cases on this branch of company law, the petitions presented were composite ones, asking for relief under section 397 as well as section 398. Thus all the cases discussed in the last chapter in connection with section 397, also involved section 398. In this chapter, we shall be discussing those and other cases in the light of section 398 and its supplementary sections.[55]

In <u>In re Hindusthan Cooperative Insurance Society Ltd.</u>,[56] which has been discussed in the last chapter in connection with section 397, relief was sought under section 398 also. In addition to the facts stated in the last chapter, Justice U.C. Law was convinced of the following facts also. The consolidated balance-sheets showed that the company did no business since 19th January, 1956, and

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54. contd.........
for relief under section 397 and in the other under section 398. We do not think any useful purpose can be served by such a procedure". See <u>ibid.</u>, at p. 108.

55. See note 39 of the last chapter.

56. A.I.R. 1961 Cal. 443. See text to note 38 of the last chapter.

yet a sum of well over Rs. 30,000/- was wrongly spent or withdrawn as Directors' fees and other expenses during the years 1957 and 1958 by the so-called Directors out of the funds of the company. The original Minute-Book which was produced at the hearing showed that Rs.16,000/- was sanctioned to be spent subsequently in law charges[57] and it further appeared, and it was not denied at the hearing that a sum of over Rs.8,50,000/- out of the compensation money was kept uninvested for well over ten months when it could earn at least 4 per cent. interest in short deposit account like the rest of the compensation money. As a result of this, his Lordship thought that the company and the shareholders undoubtedly suffered considerable loss.[58]

It was further contended for the petitioners that a material change had taken place in the management or control of the company by alteration in its Board of Directors and thus it was a fit and proper case where powers given under section 398 should be justly invoked and relief granted to the petitioners.

Justice Law held:

> "Upon the facts as I have outlined them, I consider that the acts complained of, all refer to the continuous conduct of the

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57. By which was probably meant legal charges.

58. See A.I.R. 1961 Cal. 443, at p. 452.

> affairs of the company . . . I further consider that the affairs of the company have also been conducted in a manner prejudicial to the interest of the company and lastly I find that a material change has taken place in the management or control of the company by alteration in its Board of Directors (which in fact is now non-existent) with the result that the affairs of the company are being conducted in a manner prejudicial to the interest of the company".(59)

And further:

> "I have no hesitation in holding that the facts and circumstances of this case have fully established that the relief under this section (i.e. section 398) should be justly available to the applicants". (60)

His Lordship made, among others, the following orders:[61]

(1) For removing respondents nos. 1 to 4 from the Board of Directors of the company, and restraining them from acting or respresenting themselves as directors of the company or dealing with the assets of the company including the compensation money, the accrued interest thereon and also the money lying in company's banking accounts;

(2) For restraining two persons, who were not elected as directors, from acting or representing themselves as such directors any more; and

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59. *Ibid.*, at p. 452, para 51.

60. *Ibid.*, at p. 453, para 54.

61. See *ibid.*, at pp. 453-454.

(3) For the appointment of a Special Officer to take charge of the management and affairs of the company and directing the Special Officer to purchase on behalf of the company the shares of the complaining minority at a valuation arrived at according to a formula indicated by the court.

In another case which in the first appellate stage appeared as <u>Rajahmundry Electric Supply Corporation</u> v. <u>Nageshwara Rao</u>,[62] the petitioner, one of the shareholders of the company, filed a petition under section 162(5) and (6) and section 153C of the Indian Companies Act, 1913, for winding up the company or, in the alternative, for taking action under section 153C. He alleged in the petition that he had obtained the consent of 80 shareholders, that is, more than 1/10th of the total number of shareholders. He made grave and serious allegations against the directors and as a result of the investigations of a Commission[63] appointed by Justice Bhimasankaram at the

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62. (1956) Andh. L.T. 207; (1956) 26 Comp. Cas. 55. This case was also discussed in the last chapter in connection with "oppression". See text to note 43 of the last chapter.

63. This commission comprised three shareholders of the company, two of them being the petitioner and the fourth respondent, and this commission was given power to examine all the accounts available with the company and to obtain reliable information from those in management of the business of the company. The commissioners made a thorough enquiry and submitted a unanimous report dealing with each individual head of charge stated in paragraph 15 of the petiton. See (1956) 26 Comp. Cas. 55 at p. 58.

trial stage, the facts which came to light can briefly and broadly be stated as follows:[64]

(1) Arrears of more than Rs. 3 lacs were due to Government;

(2) Arrears of more than Rs. 2 lacs were not collected from the customers;

(3) Though the corporation was purchasing annually about 21,00,000 units of energy at three annas per unit for general consumption and sold it at more than 7 annas per unit, a dividend of only 3 per cent. was declared and there were no surplus funds;

(4) The expenditure had risen when it should have gone down after the corporation had practically given up generating energy and was purchasing the same from Governmen

(5) The machinery of the corporation was left in disrepair and whatever repairs were shown in the account-books to have been effected, it was found on enquiry that most of them were non-existent; and

(6) The cash-book for 1951-1952 contained visible alterations and several pages from the ledger appeared to have been removed. There was expenditure without proper

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64. See _ibid._, at p. 62.

and valid vouchers for the years 1951 to 1954. There was practically no internal check. There were many other defects in the account-books, particulars whereof were given in the report of the commission.

Justice Bhimasankaram, after considering the various charges levelled against the respondents in the light of the commissioners' report and the explanation offered in the counter-affidavits, came to hold the view that the affairs of the company were in a muddle and that they should be remedied by drastic action. The learned Judge was also of the view that the general body was clearly apathetic or was being deliberately misled and that there was little doubt that a powerful local "junta was ruling the roost".[65]

The learned Judge held that a case had been made out for winding up the company but, as it would unfairly prejudice the interests of the company if it was wound up, his Lordship exercised his powers under section 153C and appointed two administrators for a period of six months tentatively giving them all powers of management which vested in the board of directors under the articles of association. His Lordship directed these administrators to call a general body meeting before the expiry of six

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65. See _ibid._, at p. 58.

months to record its opinion whether the administrators should continue or whether they would elect a new board of directors for the management of the affairs of the corporation.[66]

This decision of Justice Bhimasankaram was upheld in appeal[67] by a division bench of the Andhra High

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66. See ibid., at pp. 58-59.

67. Rajahmundry Electric Supply Corporation v. Nageshwara Rao, (1956) 26 Comp. Cas. 55. The division bench consisted of Subba Rao, C.J., and Krishna Rao, J. The decision of the bench was delivered by Subba Rao, C.J.
Before this bench, it was contended on behalf of the appellants that however wide the scope of section 153C might be, it did not confer on the High Court the power, (1) to interfere with the internal management of the affairs of a company and, in any view, (2) to make an order after the company's affairs had ceased to be conducted in the manner prescribed under that section. To the first of these two objections, the bench replied: "It is no doubt true that so long as a company is not wound up, a court will not interfere with the internal management of that company. But the decisions cited above and similar decisions have no bearing when the court is called upon and when it interferes in exercise of its powers under section 153C of the Act . . . We cannot import into the section limitations under which the court acts in a case not governed by the section". See ibid., at p. 61. To the second objection, the reply given by the bench was: "The fact that some acts have already been committed does not indicate that the mismanagement has come to an end. The acts already committed would only illustrate mismanagement. But the mismanagement continues and, if the serious acts of omission and commission by the directorate are allowed to continue, the company will be ruined. The mismanagement has not ended but it requires to be remedied by the drastic action now taken by the learned Judge. We cannot, therefore, accept the argument that section 153C has no application". See ibid., at p. 72.

Court and was further upheld at the second appellate stage[68] by the Supreme Court.

Before the Supreme Court, it was contended on behalf of the appellants that this application was not maintainable under section 153C as out of the 80 persons who had consented to the filing of this application, 13 were not shareholders at all, and the two members had signed twice. It was further alleged that 13 of the other persons had subsequently withdrawn their consent. In the result, excluding these 28 members, it was pleaded, the number of persons who had consented would be reduced to 52 and therefore the condition laid down in section 153C, clause (3)(a)(i),[69] was not satisfied. To this, the court replied:

> "Excluding the names of the 13 persons who are stated to be not members and the two who are stated to have signed twice, the number of members who had given consent to the institution of the application was 65. The number of members of the company is stated to be 603. If, therefore, 65 members consented to the application in writing, that would be sufficient to satisfy the conditions laid down in section 153C, sub-clause 3(a)(i). But it is argued that as 13 of the

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68. Rajahmundry Electric Supply Corporation v. Nageshwara Rao, (1956) 1 M.L.J. 95; (1956) 26 Comp. Cas. 91. The Supreme Court bench consisted of Vivian Bose and Venkatarama Ayyar, JJ., and judgment of the bench was delivered by Venkatarama Ayyar, J.

69. Clause (3)(a)(i) of section 153C laid down that in the case of a company having a share capital, a member was entitled to apply for relief under that section only if he had obtained the consent in writing of not less than 100 members or of members not less than one-tenth in number of the members, whichever was less.

> members who had consented to the filing of the application had, subsequent to its presentation, withdrawn their consent, it thereafter ceased to satisfy the requirements of the statute, and was no longer maintainable. We have no hesitation in rejecting this contention. The validity of a petition must be judged on the facts as they were at the time of its presentation and a petition which was valid when presented cannot, in the absence of a provision to that affect in the statute, cease to be maintainable by reason of events subsequent to its presentation. In our opinion, the withdrawal of consent by 13 of the members, even if true, cannot affect either the right of the applicant to proceed with the application or the jurisdiction of the court to dispose of it on its own merits".(70)

It was next contended that the allegations in the application were not sufficient to support a winding up order under section 162[71] of the Indian Companies Act, 1913. In his application, the first respondent had relied, for an order of winding up, on section 162, clause (v) and (vi). Under section 162(v), such an order could be made if the company was unable to pay its debts. It was alleged in the application that the arrears due to the Government on 25th June, 1955, by way of charges for energy supplied by them amounted to Rs.3,10,175-3-6. But there was no evidence that the company was unable to pay the amount and was commercially insolvent, and the learned trial Judge had held that section 162(v) was inapplicable. But he was of

70. (1956) 26 Comp. Cas. 91, at pp. 94-95.

71. Corresponding to section 433 of the Companies Act, 1956.

the opinion that on the facts established it was just and equitable to make an order for winding up under section 162(vi), and that view was affirmed by the division bench of the Andhra High Court in appeal.

The Supreme Court, relying on some English authorities,[72] expressed the opinion that the phrase, "just and equitable" in section 162(vi) was not to be interpreted ejusdem generis with the preceding clauses of the section, and that, therefore, whether mismanagement of directors could be a ground for a winding up order under section 162 (vi), became a question to be decided on the facts of each case. Applying this rule to the facts of this case, the Court held:

> "Now, the facts as found by the courts below are that the vice-chairman grossly mismanaged the affairs of the company, and had drawn considerable amounts for his personal purposes, that arrears due to the Government for supplying of electric

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72. The authorities chiefly relied upon were: (1) A statement of Lord Shaw in the Judicial Committee of the Privy Council in Loch v. John Blackwood Ltd., (1924) A.C. 783, 790 which is in these words, "It is in accordance with the laws of England, of Scotland and of Ireland that the ejusdem generis doctrine (as supposed to have been laid down by Lord Cottenham) does not operate so as to confine the cases of winding up to those strictly analogous to the instances of the first five sub-sections of section 129 of the British Act"; and (2) a statement in Halsbury's Laws of England, Vol. 6, p. 534, para 1035 (3rd ed. 1955) which is in the following words, "The words 'just and equitable' in the enactment specifying the grounds for winding up by the court are not to be read as being ejusdem generis with the preceding words of the enactment".

> energy as on 25th June, 1956, was Rs. 3,10,175-3-6, that large collections had to be made, that the machinery was in a state of disrepair, that by reason of death and other causes the directorate had become greatly attenuated and 'a powerful local junta was ruling the roost', and that the shareholders outside the group of the chairman were apathetic and powerless to set matters right. On these findings, the courts below had the power to direct the winding up of the company under section 162(vi), and no grounds have been shown for our interfering with their order". (73)

It was also contended that the appointment of administrators in supersession of the directorate and vesting power in them to manage the company was an interference with its internal management, which the court had no power to do. Their Lordships admitted that it was no doubt the law that courts would not, in general, intervene at the instance of shareholders in matters of internal administration, and would not interfere with the management of a company by its directors, so long as they were acting within the power conferred on them under the articles of association. But their Lordships thought that this rule could by its very nature apply only when the company was a running concern, and it was sought to interfere with its affairs as a running concern. Therefore, the Supreme Court held:

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73. (1956) 26 Comp. Cas. 91, at pp. 97-98.

> "But when an application is presented to wind up a company, its very object is to put an end to its existence, and for that purpose to terminate its management in accordance with the articles of association and to vest it in the court. In that situation, there is no scope for the rule that the court should not interfere in matters of internal management. And where accordingly a case had been made out for an order for winding up under section 162, the appointment of administrators under section 153C cannot be attacked on the ground that it is an interference with the internal management of the affairs of the company. If a liquidator can be appointed to manage the affairs of a company when an order for winding up is made under section 162, administrators could also be appointed to manage its affairs, when action is taken under section 153C. This contention must accordingly be rejected". (74)

It is respectfully submitted that this reason advanced by the Supreme Court for rejecting the appellants' contention was not appropriate. This contention could be rejected on the very simple ground that section 153C provided an exception to the rule of non-interference in the internal affairs of a company, and therefore the court, while acting under section 153C, was not precluded from adjudicating on a matter pertaining to the domain of internal affairs of a company.[75] It is only when this position is accepted that we can explain the granting of relief under

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74. Ibid., at p. 98.

75. See the reply of the division bench of Andhra High Court to the first of the two objections of the appellants, given in note 67, supra.

section 398 of the 1956 Act, which, as has been seen,[76] does not require for granting relief, that the company should otherwise be liable to be wound up under the "just and equitable" rule.

In another important case,[77] which at the appellate stage appeared as <u>Life Insurance Corporation of India</u> v. <u>Haridas Mundra</u>,[78] the Life Insurance Corporation of India had initiated this proceeding under sections 397,[79] 398 and 543 (Sch.XI) by a petition, dated May 16, 1958, with respect to the affairs of the British India Corporation Ltd., having its registered office at Kanpur. The Life Insurance Corporation (abbreviated as L.I.C. and hereinafter called "petitioner") was a member of the British India Corporation (abbreviated as B.I.C. and hereinafter called "Corporation"), and had been authorised by the Central Government under section 399(4)[80] of the Companies Act, 1956, to present a

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76. See text to note 51, <u>supra</u>.

77. Company case No. 44 of 1958 decided on 12th May, 1961 by Upadhyaya, J., of the Allahabad High Court. It does not appear to have been reported anywhere.

78. (1963) I.L.R. 1 All. 447, decided on February 14, 1962.

79. See note 87 and its text; <u>infra</u>.

80. Section 399(4) lays down:

"The Central Government may, if in its opinion circumstances exist which make it just and equitable so to do, authorise any member or members of the company to apply to the court under section 397 or 398, notwithstanding that the requirements of clause (a) or clause (b), as the case may be, of sub-section(1) are not fulfilled".

petition to the court under sections 397[81] and 398. In the petition, the petitioner had asked for the following principal reliefs[82] —

(a) Removal of Directors, Haridas Mundhra and others, respondents 1 to 7 in the petition, from the Corporation's Board of Directors;

(b) An interim injunction restraining the said respondents from acting as Directors during the pendency of the petition;

(c) Taking of steps to call a meeting of the shareholders of the Corporation for the purpose of appointing another Board of Directors; or

(d) Appointment of Special Officer;

(e) Investigation of the affairs of the Corporation and the doings of the said respondents for the purpose of finding out losses caused by them to the Corporation;

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80. contd.......

Sub-Section(1) is as follows: "The following members of a company shall have the right to apply under section 397 or 398 —

(a) in the case of a company having a share capital, not less than one hundred members of the company or not less than one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one tenth of the issued share capital of the company, provided that the applicant or applicants have paid all calls and other sums due on their shares;

(b) in the case of a company not having a share capital not less than one-fifth of the total number of its members.

81. Same as note 79, supra.

82. See (1963) I.L.R. 1 All. 447 at p. 448-449.

(f) Consequent upon such investigation and tracing out of losses an order to the said Directors to contribute to the assets of the Corporation as compensation for losses caused by their acts of misfeasance; and

(g) Any other necessary order.

On May 16, 1958, on an application of the petitioner under section 403[83] of the Companies Act, 1956, the learned Company Judge, Justice Upadhyaya, issued an injunction restraining the said Directors from acting as such until further orders. On May 23, 1958, the learned Company Judge appointed Shri H.S. Chaturvedi, an ex-judge of the Allahabad High Court, as Chairman of the Board of Directors in place of Shri H.D. Mundhra. On November 26, 1958, the learned Company Judge replaced the elected Board of Directors by an interim Board for the pendency of the petition. The interim Board of Directors consisted of ten Directors. Seven of them were appointed by name by the learned Judge and the remaining three were to be nominated, one each, by the Ministry of Commerce and Industry, Government of India, by the Reserve Bank, and by the Chairman of the petitioner. At the conclusion of this

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83. Section 403 lays down:
"Pending the making by it of a final order under sections 397 and 398, as the case may be, the court may, on the application of any party to the proceeding, make any interim order which it thinks fit for regulating the conduct of the company's affairs, upon such terms and conditions as appear to it to be just and equitable".

petition, the findings of the learned Company Judge were as follows:[84]

(a) The affairs of the Corporation were conducted in a manner prejudicial to the best interests of the Corporation and its shareholders. Having regard to all the facts and circumstances, it was necessary that the court should settle a scheme for its management under section 398 of the Act.

(b) No relief could be granted under section 543 of the Act, for —

(i) the petitioner did not file a separate application for taking action under section 543,

(ii) the evidence on record was not sufficient to prove misfeasance of the Directors and to enable the court to assess damages, if any, sustained by the Corporation,

(iii) the petitioner had failed to implead Christie and Powell, the Managing Director and the Deputy Managing Director, as respondents to its petition,

(iv) the Directors could not be fastened with any liability for losses, if any, caused to the Corporation's subsidiary, Messrs. Begg Sutherland and Company (P) Ltd., Kanpur, and

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84. See (1963) I.L.R. 1 All. 447 at p. 451.

(v) there were at the time pending in various civil courts several suits by the Corporation against various respondents Directors in respect of the transactions involved in this proceeding.

In pursuance of finding (a), the learned Company Judge directed that the Board of Directors, or better, Committee of Management, appointed by him as an interim measure, should remain in office till the end of April 1965.

While the petitioner felt aggrieved by the finding (b), the respondents felt equally aggrieved by finding (a). Hence both parties preferred appeals[85] which were disposed of together[86] by a division bench of the Allahabad High Court consisting of Mr. Justice Oak and Mr. Justice Dwivedi.

Before the division bench, the then Attorney General, Mr. M.C. Setalwad, opened the case for the petitioner-appellant and stated at the outset that he would press the claim under section 543 (Sch.XI) against Haridas Mundhra, Tulsidas Mundhra, Narendrajit Singh and Hyder

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85. Special Appeal No. 299 of 1961 filed by the petitioner and Special Appeal No. 296 of 1961 filed by the respondents.

86. Life Insurance Corporation of India v. Sri Haridas Mundhra and others, (1963) I.L.R. 1 All. 447.

Hussain only. He also stated that he would not press the case under section 397[87] of the Act. Mr. M.C. Setalvad only partly argued the case and the remaining part was argued by Mr. C.K.Daphtary, the then Solicitor-General (now Attorney General) of India. Although the petitioner-appellant in their petition had charged the respondent-Directors with acts of misconduct in respect of several matters, Mr.Daphtary stated that he would confine the case of the petitioner-appellant only to three matters relating to — (1) Samastipur Central Sugar Co. Ltd., (2) Balrampur Sugar Co. Ltd., and (3) Cawnpore Cotton Mills.[88] The division bench therefore restricted their decision to these three matters only and to the determination of liability, if any, of the four directors in respect thereof.

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87. Though section 397 was also mentioned in the petition (see texts to notes 79 and 81, <u>supra</u>), it was a case coming properly under section 398 only, as was here admitted by the learned counsel for the petitioner.

88. The Corporation's hundred per cent. subsidiary, Messrs. Begg Sutherland and Company (P) Ltd., Kanpur, which did nothing but rendering managing agent's calling, held until 1957 the managing agency of, among others, the Samastipur Central Sugar Co. Ltd., and the Balrampur Sugar Co. Ltd., and during the material time, held, together with the Corporation, considerable block of shares in both these companies. These shares were allegedly sold at an under-value and the four directors (namely, Haridas Mundhra, Tulsidas Mundhra, Narendrajit Singh and Hyder Hussain) were sought to be made liable, <u>inter alia</u>, for the resulting loss. During the material period, the Corporation owned and operated the Cawnpore Cotton Mills. These four directors were also sought to be made liable for retaining this Mill when its retention meant loss to the Corporation.

Mr. Justice Dwivedi delivered a very detailed[89] judgment, discussing carefully the various points arising in these appeals, and Mr. Justice Oak, while agreeing with this judgment of Justice Dwivedi, delivered, comparatively speaking, a brief judgment, only to add what his Lordship called "a few words".[90]

The first point of law which Mr. Justice Dwivedi took up for decision, was the denial of relief to the petitioner under section 543 (Sch.XI)[91] by the learned Company Judge, on the ground, inter alia, of want of a

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89. Report of this case covers 70 pages (from page 447 to page 516, both inclusive); out of this Justice Dwivedi's judgment covers about 59 pages and Justice Oak's judgment covers about 10 pages.

90. See (1963) I.L.R. 1 All. 447 at p. 507: "Considering that certain important questions of law have arisen in this case, I wish to add a few words".

91. Section 543 (Sch.XI) is as follows:-
Power of Court to assess damages against delinquent directors, etc. —
(1) If, in the course of the proceedings on an application made to the Court under section 397 or 398 it appears that any person who has taken part in the promotion or formation of the company, or any past or present director, managing agent, secretaries and treasurers, manager or officer of the company —
(a) has misapplied or retained or become liable or accountable for any money or property of the compan or
(b) has been guilty of any misfeasance or breach of trust in relation to the company;
the Court may, on the application of any creditor or member, examine into the conduct of such person, director, managing agent, secretaries and treasurers, manager or officer aforesaid, and compel him to repay or restore the money or property or any part thereof respectively, with interest at such rate as the Court

separate application claiming relief under that provision.[92] In this regard, his Lordship held:

> "With respect to learned Judge I have not been able to discern anything in the section, in particular in the phrase 'on the application of any creditor or member', as enacting a ban against the combining of reliefs under ss.397 and 398 with reliefs under s.543 in an application of the members of a company under ss.397 and 398, as has been done by the appellant in its petition. The section is designed to bestow an additional important right on a single member or members to seek certain reliefs for the benefit of the company, and it would be scarcely fair and proper to read in it an unrelenting ritualistic prescription of the mode and hour of prayer to the Court. If members can make a prayer during the proceedings, they may also make a prayer at the inception of proceedings especially when, as here, no prejudice to any party results".(93)

Thus Justice Dwivedi reversed this finding of the learned Company Judge and held that in an application for reliefs under sections 397 and 398, relief under section 543(Sch.XI) could also be combined as was done in this case. This view of Justice Dwivedi, though contrary to the view

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91. contd.......
 thinks just or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retainer, misfeasance or breach of trust as the Court thinks just.

 (2) This section shall apply notwithstanding that the matter is one for which the person concerned may be criminally liable.

92. See reason (i) in text to note 84, <u>supra</u>.

93. (1963) I.L.R. 1 All. 447, at pp. 453-454.

taken in a later decision[94] of the Gujarat High Court, finds strong support in an earlier decision[95] of the Madras High Court, which went even a step ahead of it, by holding that notwithstanding the omission in the petition under section 397 or section 398, to pray for relief against the delinquent directors, an enquiry into the charges against them was properly within the scope of the petition.

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94. Colaba Land And Mills Company Ltd. v. Vasant Investment Corporation Ltd. and Others, (1963) 2 Comp. L.J. 89, decided on 12th July, 1963. In this case, Miabhoy, J., held that though the existence of a prima facia case against the delinquent directors etc., in a proceeding under section 397 or section 398 was a sina qua non for a proceeding under section 543 (Sch. XI), still it was clear from the Act that petitions under section 397 or section 398 and under section 543 (Sch. XI) could not be combined into one or even made simultaneously; the petition under section 543 (Sch.XI) must follow after a prima facie case had come to light in the course of proceedings under section 397 or section 398.

95. Syed Mahomed Ali v. R. Sundaramurthy and Others, (1958) 28 Comp. Cas. 554, decided on 20th March, 1958 by a division bench of the Madras High Court consisting of Rajamannar, C.J., and Ramachandra Iyer, J. Judgment of the bench was delivered by Ramachandra Iyer, J. His Lordship held: "We are not hampered by such rigid technicalities of procedure and if the minority in a company complains of an oppression and discloses certain grounds of complaint in the petition which are made the basis for the relief, we would hold that the court should ordinarily investigate the charges. Such investigations may in certain cases be necessary even to regulate the future conduct of the company for providing against recurrence of such abuses of power by the majority. We are, therefore, of the opinion that notwithstanding the omission in the petition to pray for relief against the delinquent directors, an enquiry into the charges against them was properly within the scope of the petition. Sections 402 and 406 of the (Indian) Companies Act give ample jurisdiction to the court to dispose of the matter in the larger interests of the company". — Ibid., at pp.562-563. Emphasis added.

In regard to reason (iii)[96] advanced by the learned Company Judge for refusing relief under section 543 (Sch.XI), his Lordship did not agree that Christie and Powell, Managing Director and Deputy Managing Director, were necessary parties to the petition and that in their absence no Director might be asked to pay damages; for in his Lordship's opinion, the liability of Directors was "generally joint and several for their misfeasance".[97]

Reason (v),[98] Justice Dwivedi dismissed in the following words: "It is now agreed that none of the suits pending in subordinate civil courts cover the three transactions in dispute before us".[99]

Then coming to reason (iv)[100] of the learned Company Judge, Justice Dwivedi felt as if his Lordship was reaching the "citadel of controversy";[101] the controversy being whether the Court should in considering the complaint of a member of the Corporation about mismanagement of the affairs of the Corporation by, and misfeasance of, its Directors, confine the probe strictly to the affairs of the

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96. See text to note 84, <u>supra</u>. Reason (ii) will be taken up later.
97. See (1963) I.L.R. 1 All. 447, at p. 454.
98. See text to note 84, <u>supra</u>.
99. See (1963) I.L.R. 1 All. 447, at p. 454.
100. See text to note 84, <u>supra</u>.
101. See (1963) I.L.R. 1 All. 447, at p. 454.

Corporation by, and misfeasance of, its Directors, confine the probe strictly to the affairs of the Corporation or may also scrutinise the interfused affairs of the Corporation and its hundred per cent. subsidiary. Learned Counsel for the respondent directors, relying on the traditional notion of separate corporate personality of the subsidiary from the holding company, strongly championed the cause of keeping away from the affairs of the subsidiary company. While learned Counsels for the petitioner-appellant and the Central Government, taking their stand on business realities, vigorously argued for the extension of the probe into the affairs of the subsidiary also.

For deciding this point, his Lordship made an extensive as well as intensive survey of various matters.

In regard to inter-corporate relations of the Corporation and its subsidiary, his Lordship came to the finding that the subsidiary was treated as nothing more than a department of the Corporation and its Directors as Managers of that department; that "by and large the two bodies were fused together so that the adversity of the one inevitably created a crisis in the other".[102]

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102. _Ibid._, at p. 457. Further, at pp. 458-459, his Lordship observed: "The practical absorption of the company in the Corporation is well explained by the history of the rise and growth of holding companies. The main cause for the rise of the holding company is to be traced to the desire of a small group of

Then his Lordship turned his attention to section 398 of the Companies Act, 1956, and, in addition to it, examined a large number of other provisions[103] of this Act which, in his Lordship's opinion, provided clues to the understanding of true import of this section. After having examined the various provisions, his Lordship observed:

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102. contd......

finance and business entrepreneurs to acquire control over concentrated capital and industrial resources by the device of relatively insignificant investments by them in existing companies. It is not necessary to hold their entire share capital; control of the voting power in the existing companies is enough to place them at the head of the multi-tiered pyramid of industrial enterprises. The device of the holding company gives rise to vertical and horizontal combines. It is obvious that these combines cannot be profitably exploited without a head that is the holding company. It exercises unified control over the pyramided subsidiaries through the contrivance of inter-corporate accountancy and management (See <u>Private Corporations and their Control</u> by A.B. Levy, 1950 Edn., Vol. 2 pages 812-816)".

103. The provisions of the Companies Act, 1956, referred to and examined were sections 4, 77(1), 42(1), 295(1) & (2), 307(4), 309(6), 314(1), 375(1), 318(1) & (3)(e), 338, 294, 369, 210, 211(1) & (2), 212(1) & (3) & (5), 217(1) & (2), 214(1) & (2), 235, 237 and 239.

About section 42(1) which prohibits a subsidiary from becoming a member of the holding company, his Lordship observed at pp. 461-462: "This provision is apparently designed to prevent trafficking by the holding company in its own shares in the cloak of its subsidiary. It shows, I think, that Parliament, piercing the corporate fiction, has seen through the reality of a unique group unity of the parent and subsidiary company".

About sections 294 and 369, his Lordship observed at p. 463: "Then there are certain provisions, such as ss. 294 and 369, which also show, though indirectly, that Parliament is treating the holding company and

"These are perhaps all the salient provisions shedding light on the meaning of s. 398. They show that the Act treats the holding company and its subsidiary as a unified group rather than as separate personified institutions for purposes of ownership of capital, control of the subsidiary by the parent's directors and managing agents, their inter-corporate finance and accountancy and disclosure of the subsidiary's affairs to members of the holding company. Further, at least for one purpose (104) it looks upon the members of the holding company as members of the subsidiary". (105)

Thereafter, his Lordship discussed a number of English[106] and American[107] cases and came to the conclusion

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103. contd......
its subsidiary as a unity".
About section 214(2) which lays down that "the rights conferred by Section 235 upon members of a company may be exercised, in respect of any subsidiary, by members of the holding company as if they alone were members of the subsidiary", his Lordship observed at p. 465: "It may be observed that this provision makes a members of the holding company a member of the subsidiary for one purpose".

104. For this "One purpose", please see last para of note 103 supra.

105. (1963) I.L.R. 1 All. 447 at p. 465.

106. The English cases discussed were: (1) Scottish Cooperative Wholesale Society Ltd. v. Meyer, (1958) 3 All. E.R. 66; (2) Harold Holds Worth & Co. v. Caddies, (1955) 1 W.L.R. 352; (3) In re Darby ex parte Brougham, (1911) 1 K.B. 95; (4) Gilford Motor Co. Ltd. v. Horne, (1933) Ch. 935; (5) Smith Stone and Knight Ltd. v. Lord Mayor, Aldermen and Citizens of the City of Birmingham, (1939) 4 All. E.R. 116; and (6) Merchandise Transport Ltd. v. British Transport Commission, (1961) 3 All. E.R. 495.

107. The American cases discussed were: (1) Chicago, Milwanke & St. Paul Railway Company v. Minneapolis Civic & Commerce Association, 62 L. Ed. 1229; (2) United States of America v. Reading Company, Philadelphia, 64 L. Ed. 760; and (3) John M. Taylor v. Standard Gas & Electric Co., 83 L. Ed. 669.

that an analysis of these cases and others showed that courts were willing to lift the corporate veil where it was used to defeat public convenience, to justify wrong, to protect fraud, or to defend crime.[108] Furthermore, his Lordship thought that the courts were prone to cast aside the corporate mask and give recognition to the economic entity of a group of companies.[109]

His Lordship then clinched the issue in the following words:

> "Having regard to the history of the holding company, its inherent dangers, precedents, text-books and the enterprise-unit context of s. 398 I am led to think that the court may investigate on the application of the appellant the affairs of the company which, as already discussed had become a mere department of the Corporation. The object of the section is to liquidate mismanagement in the 'affairs' of a company. The 'affairs' of the Corporation would include also the affairs of its departments or branches". (110)

In justification of this view, his Lordship further observed:

> "If s. 398 is construed as suggested on behalf of H.D. Mundhra, then fraud, ultra vires actions and misfeasance of the Board of Directors of a holding company in the management of its wholly owned subsidiary would pass unexposed and uncensured, for enjoying sightless

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108. See (1963) I.L.R. 1 All. 447, at pp. 470-471. While drawing this conclusion, his Lordship also relied on Ballantine on Corporations, 1946 Edn., p. 294; Stevens' Law of Corporations, 1949 Edn., p. 95; and L.C.B. Gower, Modern Company Law, 2nd edn., pp. 207-209.

109. While drawing this conclusion, his Lordship, relied on L.C.B. Gower, op.cit., p. 208 and Oleck, Modern Corporation Law, 1958 Edn., Vol. 1 p. 845.

110. (1963) I.L.R. 1 All. 447, at pp. 471-472.

> support of the majority shareholders of the holding company, they would hardly allow the holding company or the subsidiary to resort to court to hasten their doom".(111)

His Lordship proceeded to add:

> "It is for this reason that several jurisdictions in the United States of America permit, even without a statute, shareholders of a holding company to maintain a 'double derivative' suit to enforce a cause of action in favour of a subsidiary company, if the Directors of both the companies have refused to institute an action in the name of either company". (112)

Thus his Lordship over-ruled reason (iv) of the learned Company Judge and held that the Directors of the Corporation could be fastened with liability for losses, if any, caused to the Corporation's hundred per cent subsidiary, Messrs. Begg Sutherland and Company (P) Ltd., Kanpur.

Having thus rejected four of the five reasons advanced by the learned Company Judge for refusing relief to the petitioner under section 543 (Sch. XI) and reserving his consideration of reason (ii) for a later stage, his Lordship turned his attention to finding (a)[113] of the

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111. Ibid., at p. 472.

112. Ibid. For this observation, his Lordship relied on a statement in Ballantine, op. cit., p. 350. This learned author further states on the same page: "The holding company owes a duty to use its control of the subsidiary to compel the subsidiary to sue to right wrongs to it, and the shareholder may in effect compel specific performance of these connected duties in a double representative suit".

113. See text to note 84, supra.

learned Company Judge where he had found that the affairs of the Corporation were conducted in a manner prejudicial to its best interests, and in pursuance of which finding he had passed orders under section 398.

In this connection, his Lordship intensively reviewed the conduct of the affairs of the Corporation during the continuance[114] of the elected Board of Directors and on the basis of this review came to the following conclusions:[115] The Management and the Board of Directors of the Corporation had reposed great trust in Hari Das Mundhra. Events had proved that that much trust was unwarranted. Hari Das Mundhra possessed a restive mind and a winsome voice; he was clever and ambitious. His qualities confounded the Directors, and his foibles trapped the Corporation into a terrible depression. Through him it bought its shareholdings high and sold them low. For him it starved its business by diverting enormous sums to the company to cushion up unwieldy investments. In the end, in panic it unloaded large share-holdings at forced prices[116] and relinquished without compensation the Managing Agency of the company in Samastipur and Balrampur

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114. That is, before the elected Board was replaced by the Interim Committee of Management appointed by the learn Company Judge.

115. See (1963) I.L.R. 1 All. 447, at pp. 499-500.

116. See also note 88, supra.

to tide over the deepening monetory crisis. Money was advanced to Hari Das Mundhra as a short-term loan presumably without interest, although the company had to pay interest on his advances. Rs. 23 lacs were not debited from his account in spite of his letter of authority.

For these reasons, his Lordship upheld finding (a) of the learned Company Judge and in the following words:

> "This resume is sufficient to show that the affairs of the Corporation were being conducted in a manner prejudicial to its interests. Removal of the Directors is therefore just and proper". (117)

The last question which fell for decision relate to reason (ii)[118] of the learned Company Judge and it was to determine whether Haridas Mundhra, T.D. Mundhra, Hyder Hussain and Narendrajit Singh[119] were guilty of misfeasan or breach of trust and were liable to make good the result loss to the Corporation.

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117. See (1963) I.L.R. 1 All. 447, at p. 500.

118. Reason (ii) given by the learned Company Judge for refusing relief to the petitioner under section 543 (Sch. XI) was that the evidence on record was not sufficient to prove misfeasance of the Directors and to enable the Court to assess damages, if any, susta by the Corporation. See text to note 84, supra.

119. These four were the only directors against whom clai under section 543 (Sch. XI) was pressed by the learn Counsel for the petitioner-appellant. Against the remaining three directors, the claim was not pressed in this appeal.

In this connection, his Lordship expressed the opinion that a Director was in the position of an agent of his company, charged with the obligation of carrying on its business; and the nature of his duties was determined partly by statute and partly by the view of agency.[120] As agent, his Lordship thought, a director owed two duties to his company — the duty of loyalty[121] and the duty of care;[122] and breach of these duties, speaking generally, amounted to breach of trust and misfeasance.

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120. See (1963) I.L.R. 1 All. 447, at p. 500.

121. About duty of loyalty, his Lordship observed:
"Varying facts - situations elude exact standardisation of either duty. But it seems to be fairly certain that he must be loyal to the company in fact and in appearance. He should not feed his or third person's interests at the expense of the company. There must never be a clash between his interests and the interests of the company. One application of these broad rules is to be found in the area of company-contracts. S. 299 obligates him to disclose his interest or concern in any contract with the company. S. 300 enjoins him from participating in the discussion of, or voting on, such contract. His presence in the directors' meeting is not counted for forming a quorum, and his vote is declared void. The section casts the injunctive net widely so as to drag in all phases of contract, — its formation, rescission and performance. Equity also would not permit him to jaundice the judgment of his co-directors with his self-interest if and when they are called upon to decide whether the company should conclude, rescind or enforce a contract in which he is interested or concerned. It is by working out the rule of loyalty in various spheres that the courts of equity- 'have raised the level of business hour, and kept awake a conscience that might otherwise have slumbered'. (See Cordozo: Growth of the law, p.96)" See *ibid.*, at pp. 500-501.

122. About duty of care, his Lordship observed:
"On the duty of care guidelines are rougher still. Some cases require a lower degree of care; others exact

The said Directors were sought to be made liable, *inter alia*, in connection with the agreement of sale for Samastipur and Balrampur shares[123] with Jamunadas Kayan and his associates.

Applying the test of loyalty, his Lordship held:

> "The conduct of Haridas Mundhra in this affair is clearly in breach of his duty of loyalty to the Corporation. To safeguard his interest he persuaded the Directors to rescind the contract. He has thus committed breach of trust and is liable to compensate the Corporation for the loss caused by his misconduct". (124)

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122. contd.......

a higher standard. The test of a reasonable and prudent businessman affords a safer guide when applied to the circumstances of each particular case. One should however make due allowance for the knowledge and experience of a Director. It may not be unpardonable for him occasionally to rely on the proven honesty, judgment and experience of his colleagues, for team-work postulates mutual trust and confidence. The somewhat speculative nature of all enterprise warrants due freedom to take risks and a bold discretion in a trying emergency. No business can be carried on with success by timid and over-cautious businessmen. A Director would therefore, not be liable for mere errors of judgments or imprudent action. A Director would not be liable for the misconduct of another Director unless he has joined with him in the perpetration of the wrong or has omitted to thwart the wrong due to his negligence. The test of negligence is not the post-event detached mind but the mind of the reasonable businessman in the heat of the moment". — See *ibid.*, at pp. 501-502.

123. See note 88 and its text, *supra*.

124. See (1963) I.L.R. 1 All. 447, at p. 504.

The difference between the aggregate price payable by Jamunadas Kayan and his group and the price actually received on subsequent sales was Rs. 6,65,492. His Lordship held Haridas Mundhra liable to make up that loss.

His Lordship exonerated the other three Directors of any liability to pay in regard to this affair and in regard to other matters[125] he exonerated all the four of these Directors.

In all these orders, Mr. Justice Dwivedi had the concurrence of Mr. Justice Oak, the other member of the division bench.

Justice Dwivedi accepted the contention of the petitioner that Narendrajit Singh[126] should not be permitted to remain on the Committee of Management because during his stewardship the Corporation had been mismanaged. Although his Lordship exonerated him of misfeasance, his Lordship, nevertheless, found it difficult to distinguish his case from that of T.D. Mundhra,[127] so as to retain the one and discard the other.

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125. For example, in regard to retention of Cawnpore Cotton Mills; see note 88, supra.

126. Narendrajit Singh was a member of the elected Board of Directors and was also appointed a member of the interim Committee of Management appointed by the learned Company Judge.

127. T.D. Mundhra was also a member of the elected Board of Directors, but he was not retained on the interim Committee of Management.

The learned Company Judge had ordered, as mentioned before, that the interim Committee of Management appointed by him would remain in office till the end of April 1965. It was argued before their Lordships that such a long term, which came to four years, was not justified. Justice Dwivedi, in this connection observed that the Corporation had been under the supervision of the court from 1958, while ordinarily a company should not be kept long under the tutelage of the court; and no special reasons appeared on record of the case to warrant a four year term for the court-appointed Directors.[128] Their Lordships, therefore, reduced the term to the end of January 1963.

Subsequently, on an application of some share-holders (who were supported by the L.I.C., the petitioner in the case under discussion, and the Central Government), the same learned bench further reduced the term of the Committee of Management so as to come to an end on November 1, 1962.[129]

In this country where technicalities and strictly mechanical views of the laws dominate, this decision of the Allahabad High Court is very refreshing as evidencing

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128. See (1963) I.L.R. 1 All. 447, at pp. 506-507.

129. See Bhagwati Prasad Bajoria v. British India Corporation Ltd., Kanpur, A.I.R. 1964 All. 75, decided on 4th September, 1962. The petitioners in this case contended that they had acquired 26½ lacs ordinary shares of the

that at least some Indian courts do not decide cases by adopting short cuts of strict legalism but are quite willing to tread the long and thorny paths of judging the merits of cases on the basis of business realities. This case presented a novel point[130] before the Allahabad High Court and it is gratifying, if we may be permitted to say so with respect, that this Court decided this point in an admirable manner. If even after this decision, a "double-derivative suit" of the type mentioned[131] by Justice Dwivedi is not permitted in this country, it is strongly urged that it should be made possible by enacting an express provision to this effect in section 398. This, it is submitted, is necessary if mismanagement is desired to be liquidated also in the subsidiary companies, more particularly, in wholly-owned subsidiaries like the one involved in this case.

In Shanti Prasad Jain v. Kalinga Tubes Ltd.,[132] (also discussed in detail in the last chapter in connection with section 397), relief was sought under section 398

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129. contd.......
Corporation from H.D. Mundhra's group, and that they, together with the Life Insurance Corporation and the President of India, owned about 75 per cent of the ordinary shares. They further alleged that all the three were in favour of early election of Directors and immediate entrustment of management to them. According to them, it was not possible for H.D. Mundhra and his group at that time to capture management or control of the Corporation.

130. So far as this country is concerned.

131. See text to note 112 and that note itself, supra.

132. A.I.R. 1962 Ori. 202. See also text to note 47 of the last chapter.

also. Justice Barman, at the trial, held the case falling under section 398 also and he granted the elaborate and far-reaching reliefs stated in the last chapter.[133] A division bench of the Orissa High Court, in appeal,[134] reversed this holding of Justice Barman and held: "The petitioner has failed to make out even a prima facie case under section 398".[135]

The Supreme Court, at the second appellate stage, upheld this decision of the division bench and held: "We therefore agree with the High Court that no case has been made out for action under section 398 on the ground that the affairs of the company were being conducted in a manner prejudicial to its interests".[136]

Judgment of the Supreme Court states that, before their Lordships the appellant relied on the following three circumstances to show that the affairs of the Company were being conducted in a manner prejudicial to its interests: namely, "(i) that when the new shares worth Rs.30 lacs were issued in July, 1958, only a small part of the share money

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133. See pp.295-306 of the last chapter.

134. See Kalinga Tubes Ltd. v. Shanti Prasad Jain, A.I.R. 1963 Ori. 189; (1964) 1 Comp. L.J. 117.

135. (1964) 1 Comp. L.J. 117, at p. 182.

136. See Shanti Prasad Jain v. Kalinga Tubes Ltd., (1965) 1 Comp. L.J. 193, at p. 212.

was received in the beginning; (ii) that the Patnaik and Loganathan groups removed Rs.7 lacs from the coffers of the Company; (iii) that the Company lost the support of the appellant".[137]

The first of these contentions, the Court dismissed in the following words:

> "It is true that when new shares of the value of Rs. 39 lacs were issued, the Company received only 15 per centum of the share money to begin with, namely, 5 per centum with the application and 10 per centum in allotment. But the evidence shows that though there was some delay in the receipt of 85 per centum of share money, shares worth Rs. 30 lacs were fully paid up in the financial year 1959-60, and the only amount outstanding in that year was Rs. 7,65,000 (i.e. 85 per centum of shares worth Rs. 9 lacs). The slight delay in the payment of the full value of the shares cannot therefore in the circumstances be said to be so prejudicial to the interests of the Company as to call for any action under section 398 of the Act". (138)

It is respectfully submitted that the problem probably was not so simple as this passage makes us believe. If we review what has been written[139] in the previous chapter in connection with discussion of Reason III of the division bench, it is clear that by avoiding, what the Supreme Court

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137. See *Ibid.*, at p. 211.

138. *Ibid.*

139. See pp.307-310 of the last chapter. The facts given and the passage quoted there have been taken from the judgment of Barman, J., at the trial. See A.I.R. 1962 Ori. 202, at pp. 211-212, para 19.

calls, "slight delay in the payment of the full value of the shares", the Company could have reduced its liability to pay interest which, as shown by the balance-sheet for the year 1958-59, was to the tune of Rs. 5,67,718. And after all, this delay was not so slight, as it extended over more than one year and eight months,[140] and further, this delay could be avoided if the majority shareholders so liked.[141]

Deliberately acting in a manner by which an easily reducible liability of the company is not reduced, is most certainly a manner of conducting the affairs of a company which is prejudicial to its interests, thus bringing this case on this basis alone under the purview of section 398.

It should, however, be stated that in this case claim for relief under section 398 was not as strong as claim for relief under section 397, which claim itself was rejected by the Supreme Court.[142]

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140. These 39,000 shares were allotted on July 30, 1958, and as the passage quoted above from the Supreme Court judgment itself shows that even at the end of the financial year 1959-60, Rs. 7,65,000 were yet to be received on the calls. That means that even after one year and 8 months, the full value of the shares had not been paid.

141. The unpaid call money could have been immediately realised. If the shareholders did not pay the call moneys according to the terms of the issue, the company could have forfeited the shares and then could have reallotted them to persons who were prepared to pay money immediately. Also see A.I.R. 1962 Ori. 202, at pp. 211-212, para 19.

142. See p.314 of the last chapter.

In A.M. Varkey v. J.R. Motishaw,[143] an application under section 398 was presented by one[144] of the members of a company. Notice was issued to the Central Government as required by section 400. The Central Government made a representation confined to affirming or denying such averments of fact in the application as were within the knowledge of the Registrar of Companies and referring to an order made by it under section 409(2) on a complaint made by the managing agents of the company, which was another company, regarding a threatened change in the Board of Directors. The company itself had entered appearance through its Managing Agents and had lent strong support to the petitioner.

The dispute culminating in the present application had arisen out of the insistence of the respondent that the estate which was the sole undertaking of the company, should be sold for a price of not less than Rs. 8,00,000. The respondent, who was himself the holder of a large number of shares, also had influence over some other shareholders and thus commanded a majority of the votes. The move to sell the undertaking of the company was strongly opposed by the petitioner and by the Managing Agents, who contended that the sale of the sole undertaking of the company which

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143. A.I.R. 1964 Ker. 114. This case fell under section 398 alone.

144. He had obtained the written consent of 16 of the other members, for compliance with the requirements of section 399.

was a profitable undertaking, would be greatly prejudicial to its interests.

It clearly appeared[145] to his Lordship, P.T. Raman Nayar, J., that unless the court interfered, the respondent would be able to carry out his avowed purpose of selling the estate by effecting such changes in the Board of Directors as were necessary for the purpose.[146] In his Lordship's opinion, if this sale was prejudicial to the interests of the company, the matter would fall both within cl.(a) and cl.(b) of sub-section (1) of section 398 and he would be justified in exercising powers under section 402 of the Companies Act, 1956, irrespective of the attitude

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145. See A.I.R. 1964 Ker. 114, at p. 116, para 7.

146. The respondent, with the aid of his supporters, requisitioned an extra-ordinary general meeting of the company for the purpose of considering and, if thought fit, of passing a resolution permitting the company to sell the estate for a price of not less than Rs.8,00,000, the other terms and conditions of the sale being such as the Board might, in its discretion, think proper. But conscious of the fact that the power of sale was vested in the Board and not in the general meeting, the respondent had proposed a further resolution to the effect that two of the directors of the petitioner's group be removed before the expiry of their term and the vacancies so caused be not filled up. If this extra-ordinary general meeting had taken place, the respondent with his superior voting strength would have got both resolutions through and, thus assured of a mandate from the general meeting and of a majority on the Board, would have been able to put through the sale. See <u>ibid</u>., at pp. 115-116, para 5.

that might have been taken in the past[147] by the managing agents of the Board of Directors or of the attitude they might take in the future, for, it was as much the court's duty to protect the company against them as against the respondent.

His Lordship agreed that there was no doubt that a company could go into liquidation, if it so wished. But for this a special resolution was necessary, whether action was taken under section 433(a)[148] or under section 484(1)(b).[149] But the respondent wanted to do this, not by a special resolution, but by an ordinary resolution; and, in the circumstances of this case, his Lordship found little point in the argument of the proposed sale being permissible under section 293(1)(a)[150] which permitted of a sale of the

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147. At one stage the managing agents and the Board of Directors appeared to be in favour of the proposed sale. See <u>ibid</u>.

148. Section 433(a) of the Companies Act, 1956, lays down that a company may be wound up by the court, if the company has, by special resolution, resolved that the company be wound up by the court.

149. Section 484(1)(b) lays down that a company may be wound up voluntarily, if the company passes a special resolution that the company be wound up voluntarily.

150. Section 293(1)(a) of the Companies Act, 1956, is as follows: "The Board of Directors of a public company, or of a private company which is a subsidiary of a public company, shall not, except with the consent of such public company or subsidiary in general meeting, sell, lease or otherwise dispose of the whole, or substantially the whole, of the undertaking of the company, or where the company owns more than one undertaking, of the whole, or substantially the whole, of any such undertaking".

whole of the undertaking of a company with the consent of the company in general meeting, in other words, on the strength of an ordinary resolution. His Lordship emphasised that this was not a sale of an undertaking with a view to embarking on some other business, but a sale which was tentamount to winding up of the company. It was also not to be forgotten that the respondent proposed to carry out his purpose, not merely by obtaining the consent of the company in general meeting for a sale, but also by getting the general meeting to effect a change[151] in the management by securing a majority for his group on the Board, so that the Board in which the power resided, could put through the sale.

In his Lordship's opinion, far from there being anything to show that the running of the estate must bring loss to the company, the evidence placed before him showed that, with proper management, it should result in conside-rable profit. His Lordship thought that unless the respondent and his supporters were stopped, it was obvious that they would effect a change in the management of the company and would see to it that, for no legitimate reasons, the sole undertaking of the company was sold at a price

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151. See note 146 and its text, supra.

which, on the face of it, seemed inadequate. This, his Lordship thought, would be highly deterimental to the interests of the company. It was precisely in circumstances like this when the ordinary provisions of the Act proved inadequate to safeguard the interests of a company, his Lordship was of the view, that resort should be had to the powers of the court under section 398.

For these reasons, his Lordship made the following order:

> For a period of five years from this day the estate, which is the sole undertaking of the company, will not be sold unless the company by special resolution resolves that it be sold. This only adds to the restriction imposed on the powers of the Board by section 293(1)(a) of the Companies Act by requiring that the consent of the company in general meeting shall be by special resolution; it does not mean that by a special resolution the members can compel the Board to effect a sale . . . . If any such special resolution, moved within six months from this date, secures the number of votes required for an ordinary resolution then, on request made within a fortnight thereof by any member of the company, the managing agents will, as agreed to by them and by the company, arrange for the purchase of the shares held by that member at a price of Rs.10/- per preference share and Rs.24.85 per equity share within a period of three months thereafter . . . . If default is made, it will be open to the member concerned to come to court, and ask for appropriate directions which might include the rescission of the direction that a sale shall be effected only on the strength of a special resolution". (152)

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152. A.I.R. 1964 Ker. 114, at p. 118, para 19.

This discussion of the cases shows that the Indian courts are getting gradually used to exercise their vast powers given to them for curbing abuse of a majority's[153] authority which hits the company as a whole.

POWER OF COURT TO CURB ABUSE WHICH HITS THE PUBLIC INTEREST

Coming to the second of the two varieties of abuses with which this chapter is concerned, namely, abuse

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153. Normally, a majority controls a company and, therefore generally, it is abuse of authority by a majority which is sought to be curbed under section 398. But, though exceptionally, cases do arise in which a minority controls and conducts the affairs of a company, in a manner which is prejudicial to the company's interests and it is gratifying to note that the Indian Courts interpret section 398 in a manner so as to cope successfully with these exceptional cases also. For example, see In re: Albert David Ltd., (1963-1964) 68 Cal. W.N. 163. In this case, speaking about the scope of section 398, Justice Mallick of the Calcutta High Court observed at p. 175: "But apart from this, I do not agree with Mr. Mukherjee that the test to be applied is whether or not the management is guilty of misfeasance or inefficiency, and incase it is found in favour of the management, the court is not entitled to make an order under section 398 of the Indian Companies Act. In my judgment, the legislature has not invested the court with such limited power as contended by Mr. Mukherjee. The power of the court is wide and whenever it is proved that the affairs of the company cannot be conducted by a properly appointed Board of Directors in accordance with the provisions of the Indian Companies Act, General Meetings to elect Directors cannot be convened, and the legality of the Directors acting as such is open to serious question resulting in a spate of litigations in which the company is necessarily involved, a case of interference under section 398 of the Indian Companies Act is made out".

of a majority's authority which hits the public interest, it should be stated that recognition of "public interest" and its protection by the court.[154] under the vast powers given to it by section 398, is an important event[155] in the life of company law of this country. This new concept has been introduced into company law with a view to making companies realise their changed role in the present national setting. The traditional view of considering a joint stock company merely as a convenient organisational device for the conduct of trade and industry within the frame-work of a law, which attempts to systematise in a formal way its structure and working methods as well as the inter-relationship between the different structural and functional elements, is no longer a valid view.[156]

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154. This power, as also other powers under sections 397 and 398, is to be exercised primarily by a Tribunal (newly constituted under the same Amending Act of 1963 which introduced this new provision about "public interest"; see the next note), but as there is a provision for appeal to the Courts, the power in this regard also ultimately resides in the courts. See also note 99 of the last chapter.

155. This innovation was introduced into the Companies Act, 1956, by the Companies (Amendment) Act, No. 53 of 1963. See also note 49, <u>supra</u>.

156. Speaking on the point, Justice P.B. Mukherjee said: "The basic concept of company law has undergone a radical transformation. A company no longer is regarded as a private device for profiteering, capital creating and business expansion. It is today treated as a vital, nationally important socio-economic institution. Economically Companies are becoming more and more important. They wield tremendous powers of life and death in the economic structure of a nation. . . .

The truth is that "this view is only a projection of the past, which continues to cast its lingering shadow on current thinking and to obscure the emergence of the reality which the joint stock enterprise respresents in the present age — as a living, vital and dynamic social organism, with firm and deep-rooted affiliations with the rest of the community in which it functions, although these affiliations may not be always readily visible to those who are only anxious 'to do', and are not interested in the meaning or significance of what they do".[157] Indeed, it is a

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156. contd......

Socially companies are assuming large responsibilities. Conditions of work and labour, are assuming great proportions. Everyday makes it clear how a successful company and an efficient company have to discover and apply the doctrine that it must be a joint venture of labour, capital, management personnel, and the public. Perhaps unnoticed the companies are becoming also educational and cultural concepts. They are fast becoming the significant agencies for private research and for raising funds for institutions of higher learning and social services. Their advertisements support the press, the newspapers and many magazines of intellectual and social utility. The overall influence of these Companies and Corporations on administrative officials and the public alike, is assuming great dimensions. The result is that commercial companies are becoming cultural milieus. Their endowments in the Universities and institutions can help a good deal in the progress of universal education, which is an essential foundation in a democracy, specially in an under-developed country. All this is intended to show how the narrow commercial character of companies to begin with (sic) are being slowly eroded by educational, social and cultural influence". — See his Inaugural Speech reported in the Proceedings of the Company Law Seminar, Company Law Series, Pamphlet No. 11, at pp. 7-8, published by the Association of Companies Secretaries and Executives, Calcutta-7. This Inaugural Speech was delivered on 30th May, 1964.

157. See D.L. Mazumdar, "Company Law and the Concept of a Responsible Company", (1964) 2 Comp. L.J. 195, at p.196.

"tribute to modern advanced thinking in the economic, legal and sociological circles of the western countries, that, it has now been able to bring up to the surface the true character of a company as a social organism, endowed with a dynamic of its own, and with duties and obligations to the rest of the community like any other sociological institution".[158] It is this truth about the changed context of the joint stock company in the modern world, which the Companies Act, 1956, particularly[159] after its amendment in 1963, attempts to bring home to the trade and industry in this country.

Since after this introduction of "public interest" into company law, there has been a good deal of talking about what is now popularly called as "corporate morality". Emphasising that "corporate morality" was a positive concept, the Chairman of the Company Law Board said:

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158. See _ibid_.

159. The Companies Act, 1956, by section 396, originally granted to the Central Government the power to order amalgamation of two or more companies into a single company if the Central Government was satisfied that the amalgamation was essential in the "national interest". The Companies (Amendment) Act, No. 65 of 1960, substituted the words "public interest" in place of the words "national interest" in section 396. But the extensive protection of "public interest", as such, is an innovation of the Companies (Amendment) Act of 1963. Also see note 155, _supra_.

"If companies are to function in the manner they are expected to, and make their due contribution to the economic development of the country, it is not sufficient for them merely to abstain from breaches of law. It is necessary that they should make a positive contribution both to the process of economic development and also to the social objectives which are the ultimate aims of such development. Both these types of contribution are important, but they should be clearly distinguished. It is important that the corporate sector should make a direct contribution to the process of economic development and maintain the desired standard and pace of progress. That by itself, however, is not enough, for economic development is a process, a means to an end, and not the end by itself. The end is the attainment of the social objectives which the process of development is expected to subserve. For the corporate sector, therefore, the standard of behaviour needs to be defined not only in relation to the process of development, but also in relation to those social objectives which are the ultimate ends of this process".(160)

Thus incorporation of "public interest" in section 398 would appear to be an attempt to regulate corporate behaviour with reference to social objectives. If a corporate act or, in other words, an act of a majority of shareholders, goes against the recognised social objectives of the nation, it should be possible to take notice of and to deal with it effectively under section 398[161] and its

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160. See R.C. Dutt, "Corporate Morality", (1964) 2 Comp. L.J. 118, at p. 119. Emphasis added.

161. It can also be taken notice of under section 388-B of the Companies Act, 1956. This section also was introduced into the Companies Act, 1956, by the same Amending Act of 1963. This section provides that the Tribunal (also an innovation of the same Amending Act of 1963) should consider references to it from the

supplementary sections. For example, if formerly the management pursued a policy of monopoly and high prices, there could hardly be a remedy for it under company law. But now it should be possible to restrain the pursuit of this policy by showing that such a policy was prejudicial to public interest.

However, it should be stated here that the expression "prejudicial to public interest", besides being a new concept, is a vague[162] concept also. For this reason, when the (Company Law) Tribunal[163] or the courts sit to decide questions of commercial morality, their task is bound to be a difficult one.[164] Due to difficulties involved

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161. contd.....
Central Government and inquire into them to ascertain whether a person is a fit and proper person to hold the office of a director or any other office in connection with the conduct and management of the affairs of any company. The Central Government may refer a case to the Tribunal if there are circumstances suggesting, _inter alia_, that the business of the company is or has been conducted and managed by such person in a manner prejudicial to public interest.

162. "No doubt, under the cover of that expression (i.e., prejudicial to public interest) it may in certain cases mean the narrow individual view of a particular bureaucratic officer in this connection, which itself may be greatly prejudicial to the public interest, because his conception of public interest may neither be sound nor sufficiently well informed". — Justice P.B. Mukherjee, _loc.cit._, at p. 13; see note 156, _supra_.

163. See note 154, _supra_.

164. "But, then with the passage of time it is possible to develop and evolve a working body of principles, just as in the same way we have done under the Industrial Disputes Act". Justice P.B. Mukherjee, _loc.cit._, at p.13.

in deciding questions of morality, the "world of law has always avoided facing morality as such on the ground that a court of law is not a court of morals".[165] Thus, by giving to the courts[166] the power to take cognizance of breach of corporate morality, this country has embarked upon an unprecedented experiment in jurisprudence.

GOVERNMENTAL POWERS TO CURB THESE ABUSES

Section 408(1) of the Companies Act, 1956, gives to the Central Government the power to appoint not more than two persons to hold office as directors of a company for such period, not exceeding three years on any one occasion, as it may think fit, if the Central Government, of its own motion or, on the application of not less than one hundred members of the company or of members of the company holding not less than one-tenth of the total voting power therein, is satisfied, after such inquiry as it deems fit to make, that it is necessary to make the appointment or appointments in order to prevent the affairs of the company being conducted, inter alia, in a manner which is prejudicial to the interests of the company or to public interest.

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165. See ibid.

166. See note 154, supra.

In lieu of passing an order as aforesaid, the Central Government may, if the company has not availed itself of the option given to it under section 265 (i.e., option to company to adopt principle of proportional representation for the appointment of directors), direct the company to amend its articles in the manner provided in that section and make fresh appointments of directors in pursuance of the articles as so amended, within such time as may be specified in that behalf by the Central Government.[167]

In case the Central Government passes an order directing the company to include in its articles provisions for appointment of directors by the principle of proportional representation, the Central Government may, if it thinks fit, direct that until new directors are appointed in pursuance of the aforesaid order, not more than two persons specified by the Central Government shall hold office as additional directors of the company.[168]

A person thus appointed as a director or directed to hold office as an additional director, shall not be required to hold any qualification shares nor shall his period of office be liable to determination by retirement

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167. See proviso to s. 408(1), Companies Act, 1956.

168. See *ibid.*, section 408(2).

of directors by rotation.[169] Further, no change in the Board of directors made after a person is appointed or directed to hold office as a director or additional director under the above-given provisions shall, so long as such director or additional director holds office, have effect unless confirmed by the Central Government.[170]

Then, section 409 gives to the Central Government the power to prevent a change in the Board of Directors of a company, if the change is likely to affect the company prejudicially. It lays down that where a complaint is made to the Central Government by the managing director or any other director, the managing agent, the secretaries and treasurers or the manager, of a company that as a result of a change which has taken place or is likely to take place in the ownership of any shares held in the company, a change in the Board of Directors is likely to take place which, if allowed, would affect prejudicially the affairs of the company, the Central Government may, if satisfied, after such inquiry as it thinks fit to make that it is just and proper so to do, by order, direct that no resolution passed or that may be passed or no action taken or that may be taken, to effect a change in the Board of Directors after the date of the complaint shall have effect unless confirmed

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169. See _ibid._, section 408 (4).

170. See _ibid._, section 408 (5).

by the Central Government; and any such order shall have effect notwithstanding anything to the contrary contained in any other provision of this Act or in the memorandum or articles of the company, or in any agreement with, or any resolution passed in general meeting by, or by the Board of Directors of, the company.[171]

Further, the Central Government shall have power when any such complaint is received by it, to make an interim order to the effect set out above, before making or completing the inquiry aforesaid.[172]

But the provisions of section 409 do not apply to a private company, unless it is a subsidiary of a public company.[173]

Moreover, the Central Government may, on the application of members,[174] appoint one or more competent persons as inspectors to investigate the affairs of the company and to report thereon in such manner as the Central Government may direct.[175] This application should show some

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171. See ibid., section 409(1).
172. See ibid., section 409(2).
173. See ibid., section 409(3).
174. The members entitled to apply should be either not less than two hundred or members holding not less than one-tenth of the total voting power in the company. In the case of a company not having a share capital, the members entitled to apply should be not less than one-fifth of the total number of members of the company. See section 235(a) & (b), Companies Act, 1956.
175. See ibid., section 235.

"good reason for requiring the investigation", and the Central Government may, before appointing an inspector, require the applicants to give security, for such amount not exceeding one thousand rupees as it may think fit, for payment of the costs of the investigation.[176] Though the expression "good reason for requiring the investigatic does not appear to be defined anywhere, it can be expected to include reasons like that the affairs of the company are being conducted in a manner prejudicial to its interests or prejudicial to public interest.

Without prejudice to its powers under the last foregoing provisions, the Central Government may appoint one or more competent persons as inspectors to investigate the affairs of a company and to report thereon in such manner as the Central Government may direct if, in its opinion, there are circumstances suggesting that persons concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards the company.[177]

If any such company is liable to be wound up under the Companies Act, 1956, and it appears to the Central Government from the report required to be submitted by the

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176. See ibid., section 236.

177. See ibid., section 237(b)(ii).

inspector under the last foregoing provision that it is expedient so to do, the Central Government may, unless the company is already being wound up by the court, cause to be presented to the court, by any person authorised by the Central Government in this behalf, (a) a petition for the winding up of the company on the ground that it is just and equitable that it should be wound up, or (b) an application for an order, inter alia, under section 398, or (c) both a petition and an application as aforesaid.[178]

CONCLUSIONS

We have seen before that the Indian courts, by and large, have been performing without inhibitions their new task of curbing those abuses of authority by the majorities which hit companies as a whole. In regard to powers of the courts[179] to curb those abuses which hit the public interest, it is too early to make any assessment yet, as the experiment has started only very recently. However, it can certainly be said that every country has got its peculiar problems, necessitating, in turn, peculiar solutions. Viewed in this light, this innovation in company law is a welcome change and it can be surmised that if the

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178. See ibid., section 243.

179. See note 154, supra.

courts[180] exercise this power not very rigidly, but keeping in view the changing needs of business realities and public interest, this innovation may prove to be a very important step towards policing corporate behaviour *vis-a-vis* public interest.

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180. See note 154, *supra*.